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CHAPTER 13

13-000 Audits at Educational Institutions, Nonprofit Organizations, and Federally Funded Research and Development Centers (FFRDCs)**13-001 Scope of Chapter**

This chapter provides auditors with an overview of their audit and reporting responsibilities at educational institutions, nonprofit organizations, and Federally Funded Research and Development Centers (FFRDCs). Sections 1 through 7 provide an overview of Office of Management and Budget (OMB) Circular

No. A-133, "Audits of States, Local Governments, and Nonprofit Organizations." Section 8 provides guidance for audits at nonprofit organizations. Section 9 provides guidance for audits at DoD sponsored FFRDCs. OMB Circulars A-21, A-110, A-122, and A-133, relevant to this chapter, may be found by searching the Acquisition Knowledge Sharing System (AKSS) web site.

13-100 Section 1 --- Cognizance of Cost Negotiation and Audit at Educational Institutions and Nonprofit Organizations**13-101 Introduction**

a. This section describes how cost negotiation and audit cognizance at educational institutions and nonprofit organizations is assigned to federal agencies under OMB Circulars A-21, A-122, and A-133.

b. This section also explains the effects of the Single Audit Act of 1984 and the Single Audit Act Amendments of 1996 on audit responsibilities and audit cognizance.

13-102 Assignment of Cognizance to Federal Agencies

a. The Office of Management and Budget (OMB), in the Executive Office of the President, controls interagency arrangements for cognizant agency assignments at educational institutions and nonprofit organizations.

b. The criteria for determining cost negotiation cognizance at an educational institution are contained in OMB Circular A-21; similar criteria for a nonprofit organization are contained in OMB Circular A-122. The criteria for determining audit cognizance at both educational institutions and nonprofit organizations are contained in OMB Circular A-133.

13-102.1 Cost Negotiation Cognizance at Educational Institutions

a. See OMB Circular A-21, Section G.11. Cost negotiation cognizance is assigned either to the Department of Health and Human Services (DHHS) or to DoD, normally depending on which department (Agency) provides more funds to the educational institution. If neither DHHS nor DoD provides funds (i.e., another federal agency is providing the funding), assignment will default to DHHS. Other arrangements for cognizance may be made based on mutual agreement between DHHS and DoD. The cognizant agency assignment period is five years. At five year intervals the funding pattern from federal agencies will be revisited, and if appropriate, cognizant agency reassignments will be made.

b. The federal agency assigned cost negotiation cognizance is responsible for negotiating and approving facilities and administrative (F&A) rates at an educational institution on behalf of all federal agencies. (At educational institutions the term "F&A rates" is used in place of "indirect cost rates." F&A is used in Circular A-21 to more accurately describe the type of cost pools that exist at educational institutions). The responsibilities of the cognizant

agency also include: resolving questioned costs; overseeing changes needed to correct contractor system deficiencies; and addressing concerns of other federal agencies.

c. Within DoD, the Office of Naval Research (ONR) is responsible for cost negotiation at educational institutions. ONR furnishes results of negotiations to other federal organizations which have awarded grants or contracts to the institutions for which ONR has cognizance.

13-102.2 Cost Negotiation Cognizance at Nonprofit Organizations

See OMB Circular A-122, Attachment A, Section E. As with educational institutions, the cognizant agency for negotiations at nonprofit organizations is the federal agency which provides the most funding. However, cognizance is not limited to DHHS and DoD, and there is no requirement to revisit the cognizant agency assignment at five year intervals. Cognizance over a nonprofit organization will not be changed unless there is a major shift in the dollar volume of the federal awards to the nonprofit organization. The responsibilities of the cognizant agency at nonprofit organizations are similar to those at educational institutions.

13-102.3 Audit Cognizance at Educational Institutions and Nonprofit Organizations

a. See OMB Circular A-133, Subpart D. OMB will assign a single federal agency as the cognizant agency for audit to each entity receiving federal awards totaling more than \$25 million a year. The cognizant agency for audit is ordinarily the Inspector General (IG). A determination of the cognizant agency for audit is made every five years. Entities to which OMB has not assigned a cognizant agency will be under the general oversight of the federal agency providing the predominant amount of funding.

b. When OMB assigns cognizance, the responsibilities of the cognizant agency for audit include: (1) ensuring that audits are timely and otherwise in accordance with the requirements of OMB Circular A-133;

(2) providing technical audit advice and liaison to auditees and auditors; (3) conducting quality control evaluations of selected non-federal audits; (4) advising the non-federal auditor and/or auditee of any audit findings; (5) ensuring resolution of audit findings and recommendations that affect agency programs; and (6) coordinating resolution of findings that affect more than one federal agency.

13-102.4 Special Audit Procedures When DoD is Not the Cognizant Agency for Audit

a. See 1-300 for guidance related to federal audit cognizance. When a non-DoD agency has federal audit cognizance over an auditee subject to OMB Circular A-133 audits, DCAA generally has no audit role at that auditee, unless cross-servicing arrangements (15-100) have been made with the non-DoD agency.

b. Circular A-133 Audit Services for NASA. As part of providing Circular A-133 audit services to NASA, DCAA will furnish the NASA Office of Inspector General staff access to Agency working papers at all locations where NASA is the cognizant audit or oversight agency as determined by Section .400(a) of Circular A-133. As part of its responsibilities as the cognizant audit or oversight agency, the NASA IG staff will coordinate with DCAA on any draft desk review or quality control evaluation recommendations impacting DCAA, prior to communicating the results to the auditee. Issues pertaining to contract audit policy identified by NASA will be forwarded to the DoDIG for consideration in carrying out its overall responsibilities of overseeing DCAA's audit work.

c. Other Audit Services for Non-DoD Organizations. If HHS or other non-DoD agency declines or is unable to provide the audit services DoD requires, DCAA can provide the services if:

- A DoD contracting officer specifically requests DCAA audit services in writing, and
- The cognizant HHS office or other non-DoD audit office provides written approval of DCAA performance of the requested audit services.

Ordinarily, DCAA audit services in such instances will be limited to audits of price proposals, public vouchers, or specific DoD program costs. When performing these services, the auditor should coordinate with cognizant federal auditors and the auditee's independent public accountant to the maximum extent possible.

13-103 Single Audit Act of 1984 and The Single Audit Act Amendments of 1996

a. OMB Circular A-128, "Audits of State and Local Governments," implements P.L. 98-502, the Single Audit Act of 1984. Circular A-128 establishes audit requirements for state and local governments that receive federal awards and defines federal responsibilities for implementing and monitoring these requirements. The Act provides that an independent state or local government auditor or public accountant may perform an audit in accordance with Circular A-128 covering all operations of the state or local government.

b. OMB Circular A-133 (see 13-207), establishes audit and reporting requirements for educational institutions and nonprofit organizations and is patterned after OMB Circular A-128. Both Circulars endorse the single audit concept.

c. On July 5, 1996, P.L. 104-156, the Single Audit Act Amendments of 1996, was signed into law. This legislation provides that an audit made in accordance with the Act shall be in lieu of any financial or financial compliance audit required under federal awards. The Act states that: "To the extent that such audit provides a federal agency with the information it requires to carry out its responsibilities under federal law or regulation, a federal agency shall rely upon and use that information . . . a federal agency may conduct or arrange for additional audits which are necessary to carry out its responsibilities under federal law or regulation . . . that Federal agency shall plan such audits to not be duplicative of other audits of federal awards."

13-200 Section 2 --- OMB Circulars and Other Federal Regulations Applicable to Educational Institutions, Nonprofit Organizations, and Federally Funded Research and Development Centers (FFRDCs)

13-201 Introduction

This section (i) describes the common types of federal awards and (ii) introduces the principal Office of Management and Budget (OMB) Circulars and other regulations applicable to educational institutions, nonprofit organizations, and FFRDCs.

13-202 Types of Federal Awards

a. "Federal awards" as defined by OMB Circular A-133 means (i) federal financial assistance and (ii) federal cost-reimbursement contracts that auditees receive directly from federal awarding agencies or indirectly from pass-through entities. A pass-through entity is a non-federal entity that provides federal awards to a subrecipient to carry out a federal program. Federal financial assistance is assistance that auditees receive in the form of cooperative agreements, grants, loans, loan guarantees, property (including donated surplus property), interest subsidies, food commodities and other assistance.

b. The federal awarding agency typically uses a grant or cooperative agreement when the principal purpose of the transaction is to stimulate or support research and development for a public purpose. Contracts are typically used when the principal purpose of the instrument is to acquire property or services for the direct benefit or use of the federal government.

c. Coordination and correspondence for requested and self initiated audits at educational and nonprofit organizations are critical for the effective use of audit resources. See 4-103 for guidance.

13-203 OMB Circular A-21 - "Cost Principles for Educational Institutions"

The most recent version of Circular A-21 is dated May 19, 1998. This circular establishes principles for determining allowable costs of grants, contracts, and other agreements with educational institutions. The Circular A-21 cost principles are incorporated by reference at FAR Sub-

part 31.3, and the allowability of costs on contracts for which FAR Subpart 31.3 is applicable will be determined by Circular A-21. DCAA audit reports and correspondence covering non-DoD awards should cite the cost principles provided for in the agreement as the authoritative regulation.

13-204 OMB Circular A-110 - "Uniform Requirements for Grants and Agreements with Institutions of Higher Education, Hospitals, and Other Nonprofit Organizations"

a. The most recent version of Circular A-110 is dated November 19, 1993. Circular A-110 establishes, among other pertinent financial management requirements guidelines for the uniform administration of grants and other agreements awarded to educational institutions, hospitals, and other nonprofit organizations. Circular A-110 does not apply to the administration of contracts, which is covered by the FAR.

b. Auditors shall consider the applicable administrative requirements of Circular A-110 in single audits conducted in accordance with Circular A-133 (see 13-207). Examples of Circular A-110 administrative requirements include:

(1) cost sharing (Circular A-110, Section .23) - this section provides standards for the auditee to satisfy when requirements related to cost sharing or matching and level of effort are contained in grants and other agreements; and

(2) property standards (Circular A-110, Section .30) - this section provides standards governing management and disposition of government property.

13-205 OMB Circular A-122 - "Cost Principles for Nonprofit Organizations"

The most recent version of Circular A-122 is dated June 1, 1998. Circular A-122 establishes principles for determining allowable costs of grants, contracts and other agreements with nonprofit organizations as defined by the circular (see 13-800). The Circular A-122 cost principles are incorpo-

rated by reference at FAR Subpart 31.7, and the allowability of costs under contracts to which FAR Subpart 31.7 applies will be determined by Circular A-122.

13-206 OMB Circular A-128 - "Audits of States and Local Governments"

a. Pursuant to the Single Audit Act Amendments of 1996 (see 13-103), Circular A-128 has been rescinded, and the audit and reporting requirements of Circular A-133 dated June 24, 1997, are extended to include coverage of states and local governments. The rescission of Circular A-128 applies to audits of states and local governments for fiscal years beginning after June 30, 1996.

b. For audits of states and local governments for fiscal years beginning before June 30, 1996, Circular A-128 (issued April 1985) remains applicable. Circular A-128 contains guidelines for performance of audits of public universities and colleges when they are included in the single audit of a state or local government. The requirements of Circular A-133 will apply to the audit of public universities and colleges when such entities are excluded from the government single audit (see 13-207.)

13-207 OMB Circular A-133 - "Audits of States, Local Governments, and Nonprofit Organizations"

Circular A-133 establishes audit and reporting requirements for state and local governments, federally recognized Indian tribes, and nonprofit organizations. Circular A-133 defines the term "nonprofit organizations" to include educational institutions and hospitals. The circular applies to FFRDCs, but excludes contracts to operate government-owned, contractor operated facilities (GOCOs).

13-207.1 Effective Date and Audit Threshold

a. Circular A-133 dated June 24, 1997 implements the Single Audit Act Amendments of 1996 (see 13-103), supersedes the prior versions of Circular A-133 dated March 1990 and April 1996, and rescinds OMB Circular A-128 (13-206). The 1997

version is effective for audits of fiscal years beginning after June 30, 1996, and does not contain a provision allowing early adoption. For auditee fiscal years beginning prior to July 1, 1996, the provisions of the circular issued March 8, 1990 will apply.

b. Circular A-133 requires auditees that expend \$300,000 or more in federal awards in a year to have a single or program-specific audit. Section 105 of Circular A-133 defines "single audit" as an audit which includes both the entity's financial statements and the federal awards. Section 105 also defines "program-specific audit" as an audit of one federal program as provided for in sections .200(c) and .235. A program-specific audit cannot be performed as part of the A-133 audit unless certain conditions are satisfied (Subpart B, section .200(c)).

13-207.2 Audit Reporting and Due Dates

a. Circular A-133 requires auditors to issue reports on three parts of an auditee's operation:

- (1) financial statements,
- (2) internal control, and
- (3) compliance with laws and regulations.

b. The auditee must submit a "reporting package" to a designated federal clearinghouse. The due date for submitting the reporting package is nine months after the end of the period audited. However, the nine month reporting requirement is not effective until audits of fiscal years beginning after June 30, 1998. This allows entities to continue to submit their reporting package under the previous requirement i.e., 13 months after the end of the period to be audited. It is imperative that FAOs work with the cognizant agency for audit (see 13-102.3) to ensure DCAA receives timely submissions.

13-208 OMB Circular A-133 Compliance Supplement

a. The Compliance Supplement to OMB Circular A-133 identifies federal requirements and suggests procedures for auditing internal control and testing compliance with laws and regulations. The most recent ver-

sion of the supplement is dated March 2000 and is to be used as part of the Circular A-133 audits covering fiscal years beginning after June 30, 1999. Auditors should use the supplement in effect for the recipient's fiscal year being audited. To ensure the supplement keeps pace with changing federal requirements, federal agencies are required to inform OMB annually of any updates that are needed to the supplement. As the compliance supplement is updated and reissued by OMB, Headquarters (PPD) will disseminate the document to the field, typically in the spring of each year. However, auditors may also electronically access and/or download sections of the compliance supplement from the following address: <http://www.whitehouse.gov/OMB>.

b. The supplement identifies compliance requirements that the Federal government expects to be considered as part of an audit in accordance with OMB Circular A-133. The supplement provides the auditor with audit objectives and procedures for the Federal programs listed in the supplement. Auditors are required to follow the provisions of Circular A-133, and shall consider the compliance supplement, and the various laws and regulations impacting auditees, in determining the compliance requirements that could have a direct and material impact on the Federal programs subject to audit (see 13-706).

c. In developing audit procedures to test compliance with the requirements of Federal programs, the auditor should refer to Part 2 of the supplement, "Matrix of Compliance Requirements," to identify which of the 14 types of compliance requirements described in Part 3 of the supplement, "Compliance Requirements," are applicable. For the audit of programs not included in the supplement, auditors should refer to Part 7 of the supplement for guidance.

d. When planning the audit, Circular A-133 requires the auditor to apply the concept of materiality to each major program rather than to all the major programs combined. Once the applicable compliance requirements are identified, the auditor must then determine which compliance requirements will be tested and reported on. Using professional judgement, the auditor will determine which compliance

requirements have a direct and material effect on each major Federal program to be tested. Also, the auditor must consider the possibility that an auditee may not have any activity subject to a specific type of compliance requirement.

e. Part 3 of the supplement lists and describes the 14 types of compliance requirements and the related audit objectives that the auditor should consider in every Circular A-133 audit. The suggested audit procedures in the supplement are broadly written to apply to many different Federal programs administered by many different auditees. Auditor judgement is necessary to determine whether the generally stated audit procedures are sufficient to achieve the audit objectives of a particular audit assignment or whether additional or alternative audit procedures are necessary for that assignment.

13-209 Cost Accounting Standards at Educational Institutions

On November 8, 1994, the CAS Board issued a final rule on the "Application of Cost Accounting Standards Board Regulations to Educational Institutions." The rule applies to educational institutions receiving a negotiated federal contract or subcontract award in excess of \$500,000 on or after January 9, 1995. The rule does not apply to contracts awarded for the operation of Federally Funded Research and Development Centers (FFRDCs), since they are already subject to the CASB rules, regulations, and standards.

13-209.1 Applicable Cost Accounting Standards

a. 48 CFR 9905 contains the following four standards that apply to educational institutions receiving negotiated contracts in excess of \$500,000 (The new standards contain essentially the same requirements prescribed in CAS 401, 402, 405, and 406):

(1) CAS 501, Consistency in estimating, accumulating and reporting costs

(2) CAS 502, Consistency in allocating costs incurred for the same purpose

(3) CAS 505, Accounting for unallowable costs

(4) CAS 506, Cost accounting period
b. CAS 501, 502, and 505 are applicable upon receipt of a CAS-covered contract. CAS 506 is applicable beginning with the first full fiscal year after receipt of a covered contract.

13-209.2 Disclosure Statement - Basic Requirements

a. The basic CAS disclosure requirements at 48 CFR 9903.202-1(f)(2) apply to contracts awarded after December 31, 1995. A Disclosure Statement Form CASB DS-2 must be submitted before contract award, if the institution receives:

(1) A single CAS-covered award of \$25 million or more, or

(2) \$25 million in CAS-covered net awards during the preceding cost accounting period, provided that at least one award exceeded \$1 million, or

(3) A CAS-covered award in excess of \$500,000 if the institution is one of the top 99 recipients of federal awards listed in Exhibit A of OMB Circular A-21; and in its most recently completed year received \$25 million or more in federal contract and financial assistance awards (i.e., contracts, grants, and cooperative agreements)

b. FFRDC CAS-covered contracts are not included when determining the educational institution's prior year awards (see 48 CFR 9903.201-2(c)(4)).

13-209.3 Disclosure Statement - Transition Period

a. For CAS-covered contracts awarded on January 9, 1995 (effective date of the CAS coverage) through December 31, 1995, the requirement to file the CASB DS-2 form will be phased in gradually (see 48 CFR 9903.202-1(f)(3)). This is to lessen the impact on the cognizant federal agencies responsible for CAS administration. The submission requirements will be phased in as follows for business units that are part of the 99 institutions listed in Exhibit A of OMB Circular A-21:

(1) Institutions listed as 1 through 20 must file within 6 months after the date of contract award

(2) Institutions listed as 21 through 50 must file within 12 months after the date of contract award

(3) Institutions listed as 51 through 99 must file within 18 months after the date of contract award

b. All other institutions not listed in Exhibit A that receive a single CAS-covered award of \$25 million or more must file within 6 months from the date of award.

c. The institution and the cognizant federal agency should establish a specific due date within the prescribed transition periods (see 48 CFR 9903.202-1(f)(4)). This is because the transition period extends through June 30, 1997, which overlaps the basic disclosure requirement that applies to awards after December 31, 1995. Therefore, conflicts in disclosure submission dates could occur. For example, an institution listed as 51 through 99 in Exhibit A that receives an award on December 31, 1995 triggering the disclosure requirement has until June 30, 1997 to submit the CASB DS-2 under the transition provisions. If the same institution submits a proposal for a single award in excess of \$25 million which requires an immediate submission of a Disclosure Statement under the basic disclosure requirement one day later (on January 1, 1996), the institution is now faced with two conflicting Disclosure Statement submission requirements. To prevent these conflicts, the CAS Board provided the authority to waive the preaward disclosure requirement under certain circumstances (see 13-208.4).

13-209.4 Disclosure Statement - Waiver Authority

The preaward disclosure requirements may be waived by the awarding agency for contracts awarded from January 1, 1996 through June 30, 1997 (see 48 CFR 9903.202-1(f)(5)). However, the waiver authority only applies if the institution executes a written agreement with the cognizant federal agency by January 1, 1996. The agreement must establish the submission date in accordance with the transition period requirements (see 13-208.3).

13-209.5 CAS Clause

The CAS clause at 48 CFR 9903.201-4(e) applies to all negotiated contracts in excess of \$500,000 with educational institutions. FFRDCs operated by educational institutions are exempt from 48 CFR 9903.201-4(e). The clause requires institutions to comply with the CAS in 48 CFR Part 9905, and file a Disclosure Statement, if required by 48 CFR 9903.202-1(f). The clause also provides for equitable adjustments to contracts when an accounting principle amendment mandated under OMB Circular A-21 requires that the institution change its established accounting practices.

13-209.6 CAS Administration

The CAS administration provisions for educational institutions are contained in 48 CFR 9903.201-7 & 9903.202-6:

a. To the maximum extent possible, the cognizant federal agency shall take the lead role in administering the CAS requirements. The cognizant federal agency is usually the federal agency responsible for negotiating indirect cost rates on behalf of the government. Administration of the CAS requirements on a contract-by-contract basis by individual contracting officers is discouraged.

b. Agencies acting as the cognizant federal agency are required to prescribe regulations establishing responsibility for making adequacy determinations on submitted Disclosure Statements.

13-209.7 CAS Audits at Educational Institutions with Predetermined Fixed Indirect Rates

At DoD cognizant educational institutions with predetermined fixed indirect cost rates (see 13-605), the auditor will not self-initiate any CAS compliance or disclosure statement adequacy audits. In those infrequent instances when the contracting officer specifically requests DCAA audit services, the auditor will build upon the independent public accountant's single audit work to preclude any duplicate audit effort and will perform no audit work other than that spe-

cifically requested. The additional effort may be an audit which relies on the work of another, an audit of elements of a submission, or an application of agreed-upon procedures.

13-210 Regulations at Educational Institutions

a. DFARS 231.3 applies the limitation on allowable compensation at DFARS 231.205-6(a)(2)(i) and (ii) to contracts with educational institutions. Although Circular A-21 applies a 26 percent limitation on administrative costs, DFARS 231.1 prohibits its application to DoD contracts awarded on or after November 30, 1993. However, the cognizant administrative contracting officer may waive this prohibition if the educational institution requests the waiver in order to simplify its overall management of cost reimbursements under DoD contracts.

b. FAR Part 35/DFARS Part 235 contain information and procurement procedures of special application to federal and DoD research and development contracts. FAR 35.003(b) implements the provisions of OMB Circular A-110 on cost sharing for both profit and nonprofit DoD auditees. DFARS 235.015-70 provides guidance on special use allowances for research facilities acquired by educational institutions which constitute an exception under limited and rare circumstances to FAR 31.3. FAR 35.014 provides for the transfer of title to equipment to nonprofit educational or research organizations. Title to equipment purchased with scientific research funds shall be vested in the auditee (or DoD grantee organization per DoD Directive 3210.2) in accordance with the guidelines contained in FAR 35.014. The regulations allow the auditee to automatically acquire and retain title to equipment costing less than \$5,000 (or a lesser amount established by agency regulation) when the auditee has the advance approval of the contracting officer. When title to equipment is vested in it, the auditee must agree, as a condition of taking title, that no charge will be made to the government for any depreciation, amortization, or use charge with respect to such equipment under any existing or

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future government grant or contract. FAR Subpart 45.5/DFARS Subpart 245.5 provides guidance for the management of government property in the possession of nonprofit organizations.

c. DFARS 242.705-3 allows for the use of multi-year predetermined indirect

cost rates for DoD awards with educational institutions. The multi-year rate can be used for a period of two to four years. See 13-605.b for additional guidance on advising the contracting officer regarding the suitability of an institution for multi-year predetermined fixed rates.

13-300 Section 3 --- General Concepts for Audit of Costs at Educational Institutions

13-301 Introduction

This section presents general concepts in the audit of costs and the evaluation of related managerial policies, procedures, and practices at universities which influence and control the level of costs.

13-302 Audit Objective

The audit objective in the DCAA audit of an educational institution is to ascertain that costs included in claims and financial reports under government agreements are reasonable, fairly presented, appropriately charged or allocated, and determined in accordance with the terms of the agreements and applicable regulations.

13-303 Educational Institution Accounting Systems

a. A major difference between the accounting systems of industrial organizations and educational institutions is the emphasis in the latter on fund accountability and on maintenance of identity of restricted vs. general operating funds. Nevertheless, the auditor should expect to find modern accounting techniques and management practices being used by institutions in keeping with their responsibilities for recording the costs of individual government grants and contracts.

b. Institutional balance sheets are normally set up by basic fund groups. Income statements reflect sources of income, such as tuition, gifts, investments, sponsored research, dining, student housing, etc. Expense statements show costs of operations generally segregated by academic departments, general and administrative, plant operations, auxiliary services, and organized research. The latter grouping does not include unsponsored, non-budgeted departmental research activities. These are not separately accounted for and are treated as part of departmental instructional activities.

c. In addition to the general standards for selected items of cost in OMB Circular A-21, some agreements specify which

types of expenditures may be treated as direct costs or establish limitations on the allowable amount of certain direct cost items. The institutions are responsible for the proper preparation of claims under contracts and reports of expenditures required under grants. Accounting systems and related administrative practices and controls must be adequate so that the institution recognizes and complies with the provisions on its various government agreements.

d. The institution's accounting system must also be adequate to meet the requirement for documentation of the institution's contributions under cost-sharing provisions of grants.

13-304 Audit Planning Data – Educational Institutions

a. To plan the audit adequately, the auditor should:

(1) Become acquainted with the total volume of auditable agreements, the magnitude and type of various sponsored programs, and the extent to which various schools, departments, or other cost centers of the institution are involved.

(2) Solicit a list of the institution's open agreements indicating the type of contract or grant, the amount, and the awarding agency.

(3) Arrange for the grantee to furnish, for each fiscal year, a statement of fund transactions, a summary statement of costs incurred on grants by cost element or category as reflected in the grantee's records, and a listing of grants in effect during the fiscal year.

b. Where a listing of contracts and grants would be voluminous or unduly time consuming for the institution to extract from its records, a summary would be sufficient. If the institution does not agree to furnish the foregoing, the auditor should prepare the data from the institution's records if this can be done with a minimum of audit effort. Otherwise, in the case of grants, the auditor should promptly notify the cognizant regional auditor to take appropriate action through DHHS channels to obtain the required information.

c. Under AID contracts, if the contractor does not furnish the data, and more than minimum effort is required to obtain it from the records, the auditor should promptly notify the Office of Audit (AG/AUD), Washington, DC 20523, to take appropriate action through AID channels to obtain the required information. In this instance, the auditor will not attempt to perform the audit until the information is obtained from the contractor.

d. As a minimum, the auditor should obtain some approximate estimate of the foregoing information for planning an all-inclusive audit scope and for measuring materiality and to satisfy certain reporting requirements as discussed in 13-700. The auditor would also use this information to ascertain the extent to which audit conclusions reached on the adequacy of internal controls, reliability of the accounting system, etc., can be applied to the various areas of performance; for example, whether previous audit opinions concerning an institution's centralized procurement system are applicable to a laboratory with autonomous responsibility for purchasing extensive specialized research materials or equipment, or whether additional audit steps should be provided in the program.

13-305 Observation of Performance Areas

13-305.1 Areas of Research Performance

a. The auditor should visit the major areas of research performance accompanied by a technical representative of the educational institution and a representative from the government technical office. By observation and inquiry the auditor should acquire an understanding of the types of research performed and the schools involved, with the view of establishing the relative percentages of space and facility utilization as between instruction (including departmental research) and organized research. Space utilization applicable to other institutional activities is usually readily determinable.

b. The knowledge so acquired will be a factor in the auditor's later audit of the reliability of the organized research and

instructional space utilization data used by the institution to support the allocation of (1) use charges and (2) plant operation and maintenance costs. Where a previously prepared schedule of space utilization is available, the reasonableness of the institution's determinations may be tested during the auditor's physical inspection of the research facilities.

c. The auditor's visit should be scheduled or repeated so that the observation takes place when representative activities are in process. For example, do not visit the research facility for this purpose during the summer vacation period, if the level of research activity is not typical of the normal academic period.

13-305.2 Areas of Nonresearch Performance

a. Similar observations should be made at institutional locations where a significant amount of work under nonresearch agreements is being performed.

b. Many on-campus costs will not apply to government agreements performed off-campus. This may also be true in the case of agreements performed in certain on-campus or near-campus laboratories or research areas which are practically autonomous in that their research activities are not supervised by deans or instructional department heads, and they maintain their own administrative, purchasing, personnel, and accounting staffs.

13-306 Treatment of Costs Applicable to Instruction

It is implicit throughout the OMB Circular A-21 cost principles dealing with identification, apportionment and allocation of costs that instructional costs, including departmental research, are to be differentiated from the costs of sponsored, organized research. The auditor should treat instructional costs as not allowable under research agreements, except as they may be specifically provided for by the terms of a research agreement.

**13-307 Audit Approach and
Coordinated Audits at Educational
Institutions**

a. DCAA audits at educational institutions should be performed on a comprehensive basis in the depth and scope required by the materiality of the total group of auditable government agreements. At many larger institutions, considerable audit complexity may arise from diversity in the services procured or activities sponsored through the government agreements and differences in the types and provisions of the agreements themselves. Even in such circumstances, the best application of audit resources would normally be:

(1) the evaluation of the reliability of the centralized administrative and financial controls, including the accounting system, which affect the incurrence and recording of costs, and

(2) the testing of selected transactions.

b. Various agreements may have different provisions requiring prior approval by the awarding agency before the institution makes designated types of expenditures, or they may set other limitations on certain transactions. It is not desirable for the audit program to include an exhaustive audit of research grants to determine what special provisions exist. Instead, the focus should be on the adequacy of the institution's own procedures and controls for ascertaining its obligations under any special provisions in the agreements and for assuring compliance. This may be an appropriate auditable area for purposes of audit planning (as discussed in the DCAA Audit Planning Manual).

c. The auditor should brief the contracts (3-200) and any other agreements where specific individual attention is required in other parts of this manual.

13-308 Basic Audit Procedures

13-308.1 Use of Permanent Files

As a preliminary step in performing the audit, review the information contained in the permanent file (see 4-405). Update this information as necessary on the basis of the current audit and evaluation of the accounting and financial procedures for recording

and reporting costs and activities relating to agreements.

13-308.2 Comparison of Agreement Provisions with Institution Policies

a. To determine whether the institution's system provides for the proper recording of costs, the auditor should review the agreements in effect and related policy statements and policy manuals of the activity awarding the agreement. These policies, in most instances, specify that direct costs will be allowed in accordance with the principles contained in OMB Circular A-21. However, there may be some exceptions and, in addition, institutions may incur costs which are not specifically covered by those provisions. Where the costs are not specifically covered in the circular or in the manuals of the awarding activity, the auditor should determine their allowability to the agreements being performed on the basis of the general principles included in the circular.

b. While changes in an approved budget applicable to an agreement generally require prior approval, the awarding activities' policy manual generally affords the institution some latitude in rebudgeting expense items.

13-308.3 Evaluation of Cost Sharing and Matching Compliance

a. Direct audit effort in connection with cost-sharing provisions of research agreements should be directed toward determining whether the institution's procedures provide for the identification and proper accountability of its cost-sharing obligations under each agreement and that controls are established to assure that the institution contributes its share of the costs of performance of the agreement (OMB Circular A-110). Test the effectiveness of the accounting and internal controls established with respect to cost-sharing by examining expenditures under selected grants.

b. The auditor should ascertain that the costs applicable to the grantee's contribution are not charged directly or indirectly to other government agreements. Costs which

are not allowable under cost principles applicable to the agreement may not be included in the institution's cost contribution (FAR 35.003(b), DoDI 3210.2, and OMB Circular A-110).

13-308.4 Use of Statistical Sampling

Statistical sampling techniques are particularly useful under the comprehensive approach. All agreements affected by the particular auditable area under evaluation should generally be considered as a single universe for the purposes of sampling, whether contract or grant, DoD or non-DoD. For developing appropriate audit recommendations and follow-up actions, appraise the results of the tests carefully to determine whether the deficiencies disclosed: (1) represent a specific procedural weakness which applies across the board to all agreements, including grants, or to particular categories of agreements, (2) indicate that the institution's records cannot generally be considered accurate or reliable, or (3) represent isolated errors applicable only to the individual transactions tested or to the individual agreement(s) represented by the deficient transactions.

13-309 Special Procedures Relating to Grants

a. Audit procedures relating to grants and other agreements with educational institutions are the same and should be integrated where practical into a comprehensive audit of the institution. Supplement audit coverage to the extent that specific audit emphasis is requested or that special provisions are contained in the agreement or outlined in any manuals on cost determination that grantors or contracting organizations might provide.

b. Issue reports on grants only on request or in accordance with the agreements with other agencies. (13-700 contains guidance on special reporting procedures applicable to grants.) There is an exception. A report will be issued when the auditor becomes aware, during the performance of normal audit procedures, of deficiencies on the part of the institution which have a significant effect on the cost of one or more grants even though a request for audit has not been made. For

example, while evaluating the accounting system, the auditor may have encountered a deficient practice in the allocation of indirect costs which tends to produce inequities in the costing of grants. Or, the auditor may have noted erroneous charges to particular grants in a random sample of transactions performed to test voucher distribution controls. In such cases, notify the grantor promptly of significant deficiencies or errors by a report which also includes an estimate of the financial effect of the deficiencies on the grants and the amount of questionable costs on particular grants, if this can be readily computed.

13-310 Procedures for AID Contracts

Agency for International Development (AID) contracts incorporate cost principles in the FAR which should be used as the framework for determining contract costs, although the services rendered may not always be in the nature of research. In AID contracts which do not contain the CAS clause, special provisions may allow as direct costs certain items normally included in indirect costs. Special cost determination procedures in AID contracts are summarized as follows:

(1) For AID contracts, indirect costs are provisionally reimbursed at rates as provided in the contract. However, final adjustment to actual allowable indirect costs is based on rates negotiated by the AID Office of Contract Management of the Bureau for Program and Management Services after receiving the auditor's advisory comments on the contractor's proposed final rates for AID contracts. The rates negotiated by AID are the authorized new provisional rates for subsequent periods until new rates are negotiated.

(2) AID contracts may also provide for reimbursement of indirect costs through the use of predetermined fixed rates.

(3) Since the basic audit data developed for the annual indirect cost report on DoD contracts is used to determine costs applicable to AID work, the auditor should ascertain that the contractor has made all adjustments required because of any special provisions of AID contracts.

13-400 Section 4 --- Audit of Direct Costs at Educational Institutions

13-401 Introduction

This section presents audit guidance for auditing direct costs distributed to organized research, instruction, and other institutional activities.

13-402 Definition of Direct Costs

Direct costs are defined in OMB Circular A-21 Section D as those costs that can be identified specifically with a particular sponsored project, an instructional activity, or any other institutional activity, or that can be directly assigned to such activities relatively easily with a high degree of accuracy. Identifiable benefit to the sponsored work, rather than the nature of the goods and services involved, is the determining factor in distinguishing direct from indirect costs of sponsored agreements.

13-403 Direct Costs by Agreement or by Group of Agreements

a. When a particular project is an individual government agreement, accounting complexity is at a minimum. The main audit considerations are adequacy of documentation, correct account coding, reasonableness of cost, and conformity with terms of the agreement and provisions of applicable regulations.

b. Occasionally, an institution's accounting system may provide for cost objectives which accumulate the direct costs of more than one related agreement. A further distribution is made to the individual agreements as direct costs. Examples are special facility or scientific discipline level project costs. These costs might include such items as salaries and wages, common materials and supplies, etc., used in connection with a project which is comprised of more than one agreement. Additional audit considerations, besides those mentioned in the preceding paragraph, are the equity of the method of distributing the project costs to individual agreements; the consistency of the institution's treating similar common

costs by the same distribution methods; and the preservation of the identity of any kinds of costs which are subject to limitation or exclusion by the terms of the agreements.

13-404 Treatment of Certain Common Costs as Direct

a. Some types of expense which are traditionally regarded as indirect in nature can be treated as direct costs when a benefit to individual government agreements can be specifically identified and an equitable method of charging the cost is followed consistently. The cost of fringe benefits and pension plans is an example. These should be applied to direct costs as well as to the various indirect cost groupings to which salaries and wages are charged. The portion applied to direct salaries and wages may also be treated as direct costs.

b. Assure that any special distribution methods applied do not tend to produce a recovery of more than actual costs and that any limitations on indirect costs are not circumvented. Sabbatical leave costs may require special consideration (see OMB Circular A-21 Section J.40).

13-405 Basic Tests of Direct Costs

Perform audit tests of direct costs in accordance with Chapter 6.

a. Test items of direct costs to ascertain whether the institution has complied with the policy and principles set forth in the awarding activity's manuals and in the terms of the agreements, with regard to the control, incurrence, and recording of these costs. If these tests disclose instances of inadequate controls, incurrence of unallowable costs or inaccurate recording, make further tests sufficient to reach a definitive conclusion as to the nature and extent of the deficiencies.

b. The audit tests may indicate a lack of adequate supporting data if the auditor cannot assure the validity or accuracy of the accounting records relating to a particular element of cost under all agree-

ments or specific categories of agreements. In such instances, obtain sufficient information to clearly show the nature and applicability of the deficiencies and the action recommended to correct the conditions.

c. The results of the test, coupled with the use of statistical projection techniques, may permit the auditor to determine a dollar amount or percentage disapproval which can be applied to an element of cost incurred under all agreements generally, or under agreements in a specific category. This is usually feasible where the cost disapproval is related to a procedural weakness in the institution's accounting controls or system which causes a definite pattern of unallowable costs to be recorded in a fairly uniform manner to all agreements, or a particular category of agreements. An example of this type of weakness would be the contractor's failure to credit material costs with purchase discounts, either actually taken or reasonably available but not actually taken.

d. As a further possibility in some instances, the deficiencies disclosed may not be related to a prevalent procedural weakness, but may occur in irregular fashion as isolated recording errors without any particular pattern being evident. In such a case, make sufficient tests to conclude whether the unallowable costs disclosed by the tests relate only to isolated agreements.

13-406 Compensation for Personal Services at Educational Institutions

13-406.1 Audit Objective

Generally, compensation for personal services, including fringe benefits and pension plan costs, is a significant percentage of total costs. The basic audit objective is to determine that the total compensation to individual employees, including fringe benefits and pension plan costs, is reasonable for the services rendered, conforms to the established policy of the institution, and is charged to government agreements in an equitable manner consistent with the provisions of OMB Circular A-21 Section J.8.

13-406.2 Basic Audit Procedures

In accomplishing the audit objective, the auditor should be guided by the procedures which are briefly described below:

a. Lack of an acceptable written policy on personnel classification, qualification requirements, promotions, salary scales, outside activities, vacation, and sick leave is a deficiency which should be remedied promptly by the institution.

b. Amounts charged directly or indirectly to organized research for personal services, except stipulated salary support, should be based on institutional payrolls which have been approved and documented in accordance with institutional practices. Stipulated salary support is a fixed or a stated dollar amount of the salary of professional or other professional staff involved in the conduct of research which the government agency agrees in advance to reimburse an educational institution as a part of sponsored research costs. The amounts stipulated for salary support will be treated as a direct cost. The provision for stipulated salary support will not be used for educational service agreements.

c. Determine that salary charges for work performed by faculty members on government sponsored agreements within the regular academic year do not exceed a proportionate share of each individual faculty member's base salary. Similarly, for work performed outside the academic year or during the regular academic year but in excess of the regular departmental workload, salary charges for individual faculty members should be at rates not in excess of their base salary rates, unless provided for by the agreement or by written approval of the sponsoring agency. For example, if the academic year at an institution is established as a nine-month period and a member of the faculty is authorized to work on sponsored agreements on a full-time basis for two of the three summer months, the monthly salary charge should not exceed one-ninth of the base salary for the academic year.

d. In the case of those personnel covered by stipulated salary support, the auditors are no longer required to verify the precise accuracy of time or effort de-

voted to research projects. Rather, the audits should include steps to determine on a sample basis that an institution is not reimbursed for more than 100 percent of each faculty member's salary and that the amount charged to government-sponsored research is reasonable in view of his or her university workload and other commitments. The stipulated salary method

may also be agreed upon for that portion of a professional's salary that represents cost sharing by the institution.

e. Solicit the assistance of cognizant government technical representatives where appropriate in making evaluations of reasonableness. Guidance on requesting and using the work of technical specialists is in Appendix D.

13-500 Section 5 --- Audit of Indirect Costs at Educational Institutions**13-501 Introduction**

This section presents audit guidance for audit of indirect costs distributed to organized research, instruction, and other institutional activities.

13-502 Audit Objective

The basic objective is to ascertain whether indirect costs are reasonably incurred, reliably recorded, and thereafter assembled in appropriate cost groupings for equitable distribution to benefiting government agreements.

13-503 Basic Provisions

a. OMB Circular A-21 Section E.1. defines indirect costs as those that have been incurred for common or joint objectives and therefore cannot be identified specifically with a particular sponsored project, instructional activity, or other institutional activity. At educational institutions, such costs normally are classified under the following indirect cost categories: general administration and general expenses, sponsored projects administration expenses, operation and maintenance expenses, library expenses, departmental administration expenses, depreciation and use allowances, and student administration and services.

b. OMB Circular A-21 Section E.2. prescribes the criteria for apportionment and allocation of indirect costs to organized research and instruction.

c. DFARS 242.770-2 requires contractors, which include educational institutions, with DoD agreements to certify proposals for billing rates or final indirect cost rates unless a waiver has been obtained from the Secretary of Defense or the Secretary of the Military Department concerned.

d. On June 29, 1995, the Office of Management and Budget issued Memorandum Number M-95-14, Subject: Equipment Capitalization Threshold Waivers under OMB Cost Principles Circulars for Universities and Nonprofit Organizations. The memorandum authorizes Federal agencies with cost negotiation cognizance to

increase the equipment cost threshold for capitalization from \$500 to \$5,000 under OMB Circulars A-21 and A-122. The waiver authority DOES NOT extend to nonprofit organizations subject to Circular A-122 that are also subject to Cost Accounting Standards 9904.404 and 9904.409. OMB plans to incorporate this increased threshold in the next circular revisions.

13-504 Reconciliation and Account Analysis

a. If the educational institution is required to certify its overhead proposals (see FAR 42.703-2), the auditor should follow the audit guidance in 6-700 pertaining to such certification.

b. Because of the multitude of income, expense, and fund accounts maintained by educational institutions, an institution's proposal for an indirect cost rate should be reconciled with its financial books of account and published annual statement. Bases for allocations should be reconciled as well as indirect cost account groupings. The auditor should assure that all incurred costs, income, and credit items relevant to the government agreements have been reflected appropriately in the institution's indirect cost.

c. Analyze the individual accounts to the extent deemed necessary to determine their allocability, reasonableness and allowability. The auditor should be guided by the auditing concepts and techniques set forth throughout this manual and the special audit considerations discussed in this chapter.

13-505 Treatment of Off-Campus Locations

The auditor's evaluation of performance areas (see 13-300) may disclose that certain agreements are performed off-campus at locations considerably removed from the institution. Such agreements may not involve the use of the institution's plant facility or the incurrence of costs for operation and maintenance of plant, use charges for building and equipment, li-

brary and possibly indirect departmental expenses. In such instances, the auditor should recommend that the institution compute an appropriate off-campus indirect cost rate which will reflect the elimination of costs not applicable to off-campus work. The institution's records should show the agreements to which the off-campus rate applies.

13-506 Treatment of Educational Institution Hospitals

13-506.1 Relationship of Hospital Operations to Institutional Activities

a. Many educational institutions operate hospitals as an adjunct to their medical schools and as a public service to their communities. This may introduce complexities in indirect cost allocations. The relationship of the hospital to the institution must be carefully understood. Experience has indicated that, except for certain general administration and general expenses, such hospitals are generally operated as autonomous subdivisions.

b. Cross-servicing activities between the hospital and other segments of the institution are usually conducted on a reimbursable basis so as to permit the proper determination of hospital patient care costs. Typical examples are the operation of utility and power facilities by the institution and the laundry by the hospital. The auditor should audit such cross-servicing costs to assure that the reimbursement rates are equitable.

c. With respect to general administration and general expenses, the hospital organization may itself perform some of these functions, the costs of which are included in their own accounts. Examples of such functions are purchasing, accounts payable, patient billing, cost accounting, etc.

13-506.2 Allocating Institution General Expenses to the Hospital

a. The most frequently used base for apportioning the institution's general administration and general expenses is total expenditures. Because the hospital performs many general expense functions for

its own account and the total expenditure base for the hospital is relatively large in relation to the institution's other activities, the apportionment of the institution's general administration and general expenses on a total expenditure base, which includes the hospital, may not be equitable.

b. In such instances the following alternative methods for distributing general administration and general expenses are suggested in order of preference:

(1) The institution's general administration and general expenses should be carefully audited to determine whether any are directly applicable only to hospital operations. Any such amounts should be included as part of the hospital costs and deducted from the pool of general administration and general expenses to be apportioned to organized research, instruction and other institutional activities on the basis of total expenditures.

(2) The apportionment can be accomplished in two stages by separating the items in this indirect cost category into two groups: one representing those items applicable to organized research, instruction and other institutional activities, and a second group representing common service functions applicable to the hospital as well as the other activities mentioned above. Dependent upon the extent of the hospital's autonomy, this second group may thus include such items as the president's office, data processing department, board of trustees, etc. The apportionment of the total acceptable cost of each group would be accomplished by relating each group total to the total expenditure base applicable to the activities serviced by the group.

(3) If neither of the above methods is practical, all general administration and general expenses incurred by the hospital and the institution can be combined and apportioned on a total expenditure basis to organized research, instruction and other institutional activities and to the hospital. This procedure, however, is theoretically incorrect because, while general expenses of the institution are applicable in part to the hospital, it is rarely true that hospital general expenses are properly apportionable to the institution. This method should, therefore, be used only if no other approach is practical.

13-507 Work Study Grants

a. At many institutions, part-time students receive Federal support through student work study program grants. When any students who are covered by the program work directly on research agreements, their total salaries for such work, whether fully or partially funded by Federal grants, should be included in the research labor base for determining and allocating applicable indirect costs. The amount of their salaries which is covered by the work study grants may not, however, be charged to government agreements as an allowable cost.

b. Where students are performing indirect functions, the portion of salary supported under these work study grants is similarly not allowable as indirect costs of agreements.

13-508 Treatment of Dining Hall Gains and Losses

OMB Circular A-21 Section B.1.d. states that dining halls will be treated as "other institutional activities." However, in some institutions where the dining halls are open to and patronized by students, faculty, and research employees, an appropriate share of reasonable losses from the operation of such dining halls may be accepted as an employee morale and welfare expense (OMB Circular A-21 Section J.14). Conversely, a share of any gains from the operation of such dining halls should be credited to the cost of sponsored agreements.

13-509 Treatment of Fringe Benefit Costs Including Pension Plans**13-509.1 Base or Pool Treatment of Fringe Benefit Costs**

a. An institution should treat fringe benefits (including pension plan) as a loading factor to be added to salaries and wages of the particular cost objectives (e.g., organized research, library, etc.) for which they were incurred rather than as an indirect cost to be distributed in total, as part of general administration and general expenses. They would be considered as part

of the direct salaries and wages applicable to each cost objective. Therefore, when direct salaries and wages of organized research, instruction, and other institutional activities are used as an allocation base to distribute in direct costs, the base amounts should include applicable fringe benefits.

b. However, if the institution's submission does not include fringe benefits as part of the allocation base, this method may be accepted if the auditor determines that substantially the same results are achieved.

13-509.2 State-Wide Benefits for University Employees

a. Special audit attention may be necessary with respect to State universities for which fringe benefit costs are paid and administered by the respective State governments. If the allowability of these costs can be substantiated through the audit of other documentation provided by the institution, the costs should not be questioned solely on the basis of not being paid by the university or recorded on its books.

b. If the institution substantiates fringe benefit costs and includes them in the allocation base for contracts and grants, the auditor should ascertain that a similar adjustment is made to all other salaries and wages included in bases for allocating indirect costs and in indirect expense pools. Accordingly, the auditor should obtain from the institution all information necessary to make these adjustments.

c. Determine the need for such adjustments early in the audit, after review of pertinent files available at the institution, and obtain the necessary information promptly in order to avoid delay in completing the audit. The auditor should urge the university to include the necessary adjustments in future indirect cost submissions.

13-510 Treatment of Other Costs and Functions**13-510.1 Student Health Services**

All student health services, including hospitals, should be treated as "other institutional activities" for the purpose of apportioning indirect costs. However,

where the health services are made available to students and all employees, an appropriate share of the cost of the operation of the activity may, in accordance with OMB Circular A-21 Section J.14, be distributed to sponsored agreements on a basis equitable under the circumstances. Population may provide such a basis where services are made available to the same extent to all categories.

13-510.2 Television and Radio Stations

Such activities owned and/or operated by an educational institution should be treated as "other institutional activities" for the purpose of apportioning indirect costs.

13-510.3 Planning and Development for the Institution

The auditor should ascertain that all preliminary planning and development costs pertaining to contemplated new construction are being deferred for future incorporation in the cost of the new construction. General institution planning and development expense may be accepted for distribution to all activities of the institution, including sponsored agreements.

13-510.4 Scholarships and Student Aid Costs

Any remission of tuition to students for research work performed is allocable as a cost of the research and should be included in the base for allocation of indirect costs in the same manner as compensation of regular employees engaged in organized research. The costs of scholarships, fellowships, and other forms of student aid apply only to instruction. The costs of administering scholarships and student aid may be allocable in part to research in cases where the students perform services under research agreements. (See OMB Circular A-21 Section J.41).

13-510.5 Grant Support for Computer Facilities

The National Science Foundation (NSF) awards certain grants to educational institu-

tions for the purpose of defraying part of the cost of acquiring or operating computer facilities. Such grants are for the purpose of supporting educational usage and nonsponsored research. No part of the grant is intended to be used to reduce the cost of sponsored research, whether sponsored by the government or by others. NSF grants will clearly indicate if it is intended that the benefits of the grant be restricted in any way. Where the grant does not specify such an intention, the auditor may properly apply the grant funds to reduce the overall cost of acquiring or operating the computer facility for the purpose of determining sponsored research costs.

13-511 Cost Distribution Bases

13-511.1 Base Period and General Criteria for Distribution

Because educational institutions generally close their books of account annually, the base period for distribution of indirect costs should be the fiscal year. As in the case of any apportionment and allocation, the overall objective should be to select the method for each indirect cost category which will distribute the costs to all of the benefiting activities of the educational institution. Each indirect cost category should be apportioned and allocated separately using the most appropriate base for distribution (see OMB Circular A-21 Section E.2). Actual conditions must be taken into account in selecting the method or base to be used in distributing individual cost groupings to applicable cost objectives.

13-511.2 University "Cross Allocation" Method

Prior to apportionment, there normally should be added to allowable expenses appropriate shares of employee fringe benefit expenses applicable to salaries and wages. OMB Circular A-21 Section E.2.e. lists an order of allocation for indirect cost categories. However, a cross allocation of costs between two or more indirect cost categories may be used if such allocation will result in a more equitable allocation of costs in which case the

specified order of allocation would not apply. The distribution of a portion of one indirect cost category to another does not change the nature of the item, as defined, although its initial identity may be lost in the distribution process. Figure 13-5-1 illustrates this process.

13-511.3 Methods of Selecting Bases

a. Cost analysis studies may be used when they result in more accurate and equitable distribution of costs. Such studies may more appropriately consider weighting factors, population, or space occupied.

b. The essential consideration in selecting the distribution base in each instance is that it be the one best suited for assigning the pool of costs to cost objectives in accordance with the relative benefits derived; a traceable cause-and-effect relationship; or logic and reason, where neither benefit nor cause-and-effect relationship is determinable. The following paragraphs explain the bases more commonly used.

13-511.4 Total Expenditures Base

a. This term means the sum of all expenditures for a given cost objective, such as for the institution as a whole, instruction, organized research, other institutional activities, etc. When used to denote a base for distribution of indirect costs, the term "total expenditures" should be exclusive of the indirect costs to be apportioned and/or allocated.

b. Any expenditures included in the general administration and general expenses pool that are applicable solely to functions or activities which are properly categorized as "other institutional activities" (see OMB Circular A-21 Section B.1.), should be reclassified from such pool to the total expenditures base. This reclassification is necessary in order to apportion to such functions and activities their proper share of general administration and general expenses.

c. The expenses for operation and maintenance of the library, exclusive of any portion of such expenses that are applicable to general administration and

general expenses, should be included in the total expenditures base.

d. When total expenditures is used as a base for distributing indirect costs, total expenditures should be exclusive of capital expenditures.

13-511.5 Direct Salaries and Wages Base

When used, this base should include all salaries and wages and their equivalents (e.g., tuition remissions) applicable to instruction, including departmental research, and to organized research. The auditor should ascertain that the base includes all salaries incurred under grants and cost-reimbursement and fixed-price contracts and subcontracts. See 13-509 for discussion of application of fringe benefit costs to base.

13-511.6 Space Utilization Base

Whenever space utilization is used as a base for apportionment and allocation of indirect expenses to a cost objective, it should be supported by detailed records. The period used to develop the space utilization base should be representative of the usage during the entire period (see 13-512.3). Whenever appropriate, the services of government technical personnel should be solicited to assist the auditor. Guidance on requesting and using the work of technical specialists is in Appendix D.

13-511.7 Population Served Base

Whenever population served is used as a base, the auditor should ascertain that all personnel served, including evening, summer, extension, and part-time students as well as the general public, are represented in the total and are appropriately weighted.

13-511.8 Modified Total Cost Base

Modified total costs consist of salaries and wages, fringe benefits, materials and supplies, services, travel, and subgrants and subcontracts up to \$25,000 each. This is an alternative base for allocating some indirect cost categories to serviced or bene-

fitted functions. This base shall be used to distribute indirect cost pools to applicable sponsored agreements unless it can be demonstrated that another base would produce more equitable results (see OMB Circular A-21 Section G.2.)

13-512 Cost Classification

The following guidance is furnished for use in the audit of indirect cost functional categories.

13-512.1 General Administration and General Expenses

a. General administration and general expenses are defined in OMB Circular A-21 Section F.3. Expenses in the general administration and general expense pool should be excluded when comparable expenses are authorized as direct costs to sponsored agreements.

b. The most commonly used base for apportioning general administration and general expenses to instruction (including departmental research), organized research, and other institutional activities, is total expenditures. However, purchases of disproportionately large amounts of direct material for government sponsored contracts, or other similar significant factors may cause the use of a total expenditure base to be inequitable. In such cases a different base which will eliminate the inequity should be used (see OMB Circular A-21 Section E.2.).

13-512.2 Sponsored Projects Administration Expenses

a. These expenses are defined in OMB Circular A-21 Section F.5. They represent costs allocable to the major functions of the institution under which the sponsored projects are conducted. Most institutions, particularly those that do not maintain a separate research office, do not provide separate accounting classification for this type of expense, but include these items in departmental administration or general administration and general expenses. Unless there is sufficient justification for doing so, the auditor should not attempt to

segregate and establish a separate expense pool for these items.

b. Sponsored projects administration expenses are generally limited to those incurred by the separate organization(s) (see OMB Circular A-21 Section F.5.a.) Pursuant to OMB Circular A-21 F.5.c., where sponsored projects are separately administered, it may be necessary to exclude a portion of the normal institutional general administration expenses from allocation to sponsored agreements; e.g., purchasing or receiving, in order to avoid duplication.

13-512.3 Plant Operation and Maintenance Expenses

a. Usually, plant operation and maintenance expenses (see OMB Circular A-21 Section F.2.) fall into three main categories; i.e., (1) utility services, (2) custodial services, and (3) ordinary or normal repairs and maintenance. If the institution distributes these costs separately, the auditor should evaluate the basis of such distribution to all applicable cost objectives. Custodial services and utility services may properly be related to space utilization. On the other hand, where a work order system is in effect, the information ascertainable from the work orders is the most accurate method of determining the proper cost objective of repair and maintenance costs. If a work order system is not in effect, space utilization or other base which will provide the most equitable distribution of the costs may be used.

b. Some institutions charge operation and maintenance expenses initially to other institutional activities, buildings, groups of buildings, departments or subdivisions. Such charges should be evaluated to determine whether they reflect fairly the services involved.

c. Some institutions use weighting factors in distributing plant operation and maintenance costs which result in a larger cost per foot for space used for organized research than for other uses. Such use of weighting factors should be supported by a well documented comprehensive study. The auditor should evaluate the justification and ascertain whether the results are equitable.

d. The apportionment and allocation to their proper cost objectives of plant operation and maintenance costs and use and/or depreciation charges applicable to buildings and equipment, should ordinarily be on the basis of space utilization. Emphasis should be placed on assuring an equitable distribution to other institutional activities, classrooms, auditoriums, laboratories, and other instruction areas where organized research is not conducted. Some of the space may be applicable entirely to organized research or jointly to instruction and organized research. Commonality to both instruction and organized research results principally from graduate students who perform basic research under government agreements aimed at obtaining advanced degrees.

e. Some institutions treat plant operation and maintenance costs and use allowance and/or depreciation applicable to buildings and equipment for organized research and instruction as a combined amount which is allocated to research and instruction on the basis of respective salaries and wages. Such allocation is unacceptable as it fails to provide for student usage of space and facilities. To be acceptable the total cost being allocated should be reduced in an amount sufficient to cover student space usage of classrooms, auditoriums, laboratories, etc.

13-512.4 Library Expenses

a. These expenses (see OMB Circular A-21 Section F.6.) relate to the operation of a single central facility and individual specialized facilities located in various schools, departments, and laboratories which provide a variety of services to the entire institution. The facilities utilizing floor space, light, heat, furniture, carpeting, book shelves, tables, periodicals, books, microfilming and storage, technical reports, personnel, etc., are available to the total population for the institution. Consequently, the proper base for expense allocation is total population. In developing a population base, all users of the library ordinarily should be included and properly weighted. This would include evening, summer, extension, and other part-time students as well as the general public to the

extent that such usage can be determined or reasonably estimated. The basis proposed by the institution must be supported by data developed periodically on actual experience for representative periods.

b. Where the institution has a more complex library system, the auditor should determine whether a more refined process of allocation is required. For example, if several autonomous, specialized libraries exist, or if there is more than one centralized facility, and if the relative benefits derived from the libraries by the government agreements vary, a distribution such as in a. above should be made for each of the libraries. The extent of audit analysis warranted depends upon the materiality of the share of the library costs which is allocable to the government agreements and the degree of difference among the libraries in benefits received on government sponsored work vs. other institution functions and activities.

c. The cost of books, periodicals, and materials should be reviewed for reasonableness. The cost of large and unusual purchases of books which in effect constitute an expansion of the library, should be reviewed for applicability to the period under audit. Consideration should be given to spreading the cost of unusually large purchases of books over a period of several years. Rare book purchases should be examined for reasonableness and allocability to research agreements. Costs incurred in the purchase of rare books (museum type) with no value to sponsored agreements should not be allocated to them (OMB Circular A-21 Section F.6.a.).

13-512.5 Departmental Administration Expenses

a. Departmental administration expenses are expenses incurred for administrative and supporting services that benefit common or joint departmental activities or objectives in academic deans' offices, academic departments and divisions, and organized research units (OMB Circular A-21 Section F.4.). Acceptance of these expenses must be based upon a determination that the department is engaged in organized research, and the departmental administrative personnel perform functions benefiting

organized research. Functions benefiting organized research include programming, recruiting personnel, supervising sponsored research, reviewing work progress, and engaging in the administration of sponsored agreements. Where organized research is performed in a separate facility with its own administrative organization, evaluate the allocation of departmental administration expenses to such organized research to determine if it is equitable based on the benefits derived.

b. Give particular attention to any allocation of a portion of the salaries of the institution's department heads and faculty to academic administration expenses. Such allocation is limited to amounts attributable to administrative duties. However, section F.4.a.(2)(a) of OMB Circular A-21 allows recovery of salaries and fringe benefits for the administrative work of certain professionals at a rate of 3.6% of modified total direct costs. (Section G.2 of the Circular defines modified total direct costs.) Expenses covered by the allowance are to be excluded from the departmental administration indirect cost pool. No documentation is required to support this allowance. This section is sufficiently vague as to invite misinterpretations which may result in significant excess cost allocations to the government. Accordingly, carefully evaluate forward pricing and incurred cost submissions to determine whether the allowance, if claimed, is questionable. Question the allowance if it results in unjustified or inequitable cost allocations (e.g., if it is proposed or claimed for departments not incurring expenses covered by the allowance or which charge such expenses as a direct cost).

c. Exclude expenses treated as departmental administration expenses when similar expenses are charged as direct costs to organized research and to instruction. Most department heads, divisional heads, and deans, may spend some portion of their time teaching. When, for example, a department head devotes one-fifth of the time to teaching and the remainder to departmental administration, his or her salary should be distributed accordingly. The 20% charged to instruction should be included in the instruction direct salary base.

The remaining 80% should be charged to the departmental administration expense pool and ultimately allocated to both organized research and instruction.

d. OMB Circular A-21 Section F.4.b. provides that these expenses should be distributed through bases applied to cost groupings in accordance with OMB Circular A-21 Section E.2. In many cases the total cost of direct salaries and wages of organized research and instruction will be an appropriate base for the allocation of departmental administration expenses to organized research. Because organized research may not be conducted in all departments and schools within an educational institution, it would be inequitable to allocate departmental administration expenses on the basis of a composite rate. In such cases, the expenses of offices of the deans of the schools should first be allocated to the departmental administration offices within the school. Then the expenses of each departmental administration office can be allocated to organized research and instruction. Adoption of this procedure will result in an equitable allocation of the expenses of offices of deans and departmental administration expenses to organized research.

13-512.6 Depreciation and Use Allowances

a. Depreciation or use allowances (see OMB Circular A-21 Section F.1.) compensate an educational institution for the loss of useful value of buildings, capital improvements, and equipment resulting from their use in the performance of sponsored agreements. It should be remembered that a combination of the two methods may not be used in connection with a single class of fixed assets.

b. The following procedures should be used in the audit of depreciation and use allowances:

(1) Ascertain that the institution's proposal does not include the cost of land and that the cost of buildings and equipment purchased or donated by the government have been excluded.

(2) Review the institution's records and determine that the value placed on buildings and equipment represents actual or

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reasonable estimate of acquisition cost and not replacement cost.

(3) Ascertain that the equipment for which depreciation or use allowances is proposed is being used on sponsored agreements.

(4) When depreciation is proposed, the service lives placed on the properties by the institution must be evaluated. If needed, assistance from the cognizant government technical personnel should be

sought (see Appendix D). The institution's replacement policy may be an important factor in establishing proper service lives.

(5) The allocation and apportionment of depreciation or use allowances for buildings and equipment to their proper cost objectives should ordinarily be on the basis of space utilization. The audit guidance contained in 13-512.3 is helpful in the audit of depreciation and use charges.

Figure 13-5-1
Format for Allocation of Indirect Costs

Indirect Cost Categories					Major Activities			
Indirect Costs	Operation & Maintenance	Gen. Admin. & Gen. Exp.	Dept. Admin.	Sponsored Projects Admin.	Library Expense	Organized Research	Instruction	Other Institutional
1. Salaries and other indirect expenses incurred by functional categories	\$663,000	\$104,000	\$278,000	\$12,000	\$386,000	\$40,000	\$140,000	\$79,000
2. Fringe benefit and pension plan costs - \$74,000 total indirect	14,000	6,000	15,000	1,000	18,000	4,000	14,000	2,000
3. Equipment use/depreciation charges - \$172,000 total	11,000	5,000	4,000	1,000	4,000	19,000	117,000	11,000
4. Building use/depreciation charges - \$217,000	11,000	8,000	1,000	1,000	3,000	29,000	144,000	20,000
5. Operation and maintenance	(699,000)	26,000	2,000	1,000	15,000	59,000	492,000	104,000
6. General admin. & general expenses		(149,000)	100	200	9,000	6,000	128,000	5,700
7. Departmental admin. expense			(300,100)	--	--	74,000	191,000	35,100
8. Sponsored projects admin. expense				(16,200)	--	16,200	--	--
9. Library expenses					(435,000)	79,000	255,000	101,000
10. Total indirect expense						\$326,200	\$1,481,000	\$357,800

NOTE: The above format is intended only to illustrate the process and sequence of allocation. It does not imply reasonable expense levels or ratios nor mandatory accounting methods. When appropriate for use as an audit worksheet or audit report exhibit, the basis and methods of apportionment should be adequately explained in footnotes or supporting schedules cross referenced as required.

13-600 Section 6 --- Establishing Indirect Cost Rates at Educational Institutions**13-601 Introduction**

This section describes the various methods by which government agencies predetermine, and/or retroactively settle, the indirect cost rates to be used for costing grants and contracts with an educational institution, along with the contract audit responsibilities involved in this process.

13-602 Rates for Sponsored Agreements

Unless significant inequities would result, a single uniform rate should be used to distribute to individual sponsored agreements the indirect expenses apportioned to organized research. OMB Circular A-21 Section G.1.b. discusses conditions under which use of a single rate would not be appropriate. Dependent upon the conditions, offsite rates or separate rates for different segments of the institution may be appropriate.

13-603 Rates for Educational Service Agreements

Educational service agreements may be performed as part of general instructional activities. If these agreements require the determination of actual indirect cost rates (some grants contain administrative ceilings on these rates), additional analysis would be required. Not all the expenses associated with the general instructional activities would be allocable to particular services being performed under these agreements under the cost principles of OMB Circular A-21, and the policies of the agencies concerned. Many instructional expenses may be related to the education of the general student body and may be unrelated to specialized educational services rendered under government agreements.

13-604 Simplified Procedure for Small Institutions

Where the total direct cost of Federal work does not exceed \$3 million in a fiscal year, OMB Circular A-21 Section H. provides a simplified method for computing indirect cost rates which the institutions

may elect to use. The auditor should encourage the use of this method where appropriate, since audit scope could be reduced and resources conserved. However, the auditor may find, from prior experience or from a cursory review of the institution's financial reports and supporting information, that the results would not be equitable, or that the accounting information required for use of the abbreviated procedure is not available. If so, notify the institution and recommend to the government administrative activity that the institution should be required to use the regular procedure.

13-605 Predetermined Fixed Rates

a. OMB Circular A-21 Section G.4. cites the authority for the negotiation of predetermined fixed indirect cost rates for cost reimbursement type contracts for research and development. A further provision of FAR 42.705-3(b), is that a predetermined rate should be used only if the same basis is used on all government contracts with the institution. Depending upon the circumstance, a rate may be negotiated at the beginning of a fiscal year for application in ensuing contracts performed during the year, or, it may be established during the pricing negotiations of an individual contract.

b. DFARS 242.705-3(b) was changed in October 1994 to allow for the use of multi-year predetermined indirect cost rates for DoD contracts with educational institutions. The multi-year rate can be used for a period of two to four years. The pertinent factors that the auditor should consider when providing advice on the use of multi-year rates include: (1) the stability of the indirect cost rates from year to year, (2) the accuracy of the estimating system to forecast indirect cost rates (compare forecasted rates to actual rates for the last 3-5 years), (3) the adequacy of the internal control systems---especially the university's internal controls for identifying and segregating unallowable costs and for ensuring that intermediate and final cost allocations are equitable, and (4) the amount of questioned costs reported in the last 2-3 annual audits

of the university's incurred cost and forward pricing proposals.

c. The auditor will evaluate an institution's proposals for predetermined rates when requested to do so by the cognizant administrative agency. The same attention should be given to the equity and propriety of the methods for allocating and applying indirect costs used in these proposals for the evaluation of historical indirect costs discussed earlier in this chapter.

d. Where predetermined indirect cost rates are negotiated, the auditor will apply the rates in subsequent audit determinations where indirect costs of the same period are includable. However, if the auditor finds that the predetermined rates are not applied consistently to all the contracts affected, for example, as to uniform treatment of the institution's direct and indirect cost classifications, inform the interested contracting officers promptly and recommend appropriate changes.

e. DoDIG Audit Policy Memorandum 95-1, dated August 25, 1995, generally prohibits the DCAA auditor from participating in the single audit for any fiscal year that an educational institution has predetermined fixed rates. Because the audit risk at educational institutions with both predetermined fixed rates and less than \$50 million of indirect costs charged to Federal research and development awards is considered low, the independent public accountant will perform the entire single audit. DCAA will not perform any audit effort at these locations unless specifically requested by the contracting officer (see 13-209.7). DCAA will continue to perform limited audit work at DoD cognizant educational institutions with predetermined fixed rates and \$50 million or more charged to Federal research and development awards.

13-606 Negotiated Fixed Rates

a. As explained in OMB Circular A-21 Section G.5., when fixed rates are negotiated in advance for a certain time period, the over (or under) recovery may be included as an adjustment to the indirect cost

for the next rate period. When the rate is negotiated before the carry-forward adjustment is determined due to delay in audit, the carry-forward may be applied to the next rate negotiation.

b. Unrecovered amounts under lump-sum agreements or cost-sharing provisions of prior years shall not be carried forward for consideration in the new rate negotiation.

c. The carry-forward procedure does not apply to cost-type research agreements covering work performed in wholly or partially government-owned facilities.

13-607 Indirect Rates for Training and Other Non-Research Agreements

a. Increasingly, educational institutions are being awarded contracts and grants for conducting training and other programs not of a research and development nature. The types of services rendered under these agreements may vary greatly. Some of these programs may utilize the institution's instructional and other related facilities, while others may be completely separate from all campus activities and facilities. These differences may necessitate a careful consideration of the institution's activities and related indirect costing structure. In rate determinations, the auditor should maintain a balance between the undesirable effects of inequitable distributions of particular indirect cost items on the one hand, and fragmentation or proliferation of indirect cost rates on the other. The auditor must evaluate the circumstances at each institution in terms of the relationship of cost benefits for the programs involved and the materiality of the items.

b. In some cases, indirect cost rates developed primarily for research and development agreements have been incorporated as provisional rates in contracts for training or other programs. If the auditor believes the provisional rates are inappropriate and are contributing to a significant inequity in accordance with the preceding paragraph, the auditor should notify the contracting officer setting forth the reasons and recommended rates.

13-700 Section 7 --- OMB Circular A-133 Audits and Reports**13-701 Introduction**

This section provides guidance on planning the audit including (1) the evaluation of internal control over compliance, (2) the evaluation of compliance related to federal programs, and (3) the preparation and distribution of audit reports to meet the regulatory requirements of OMB Circular A-133, "Audits of States, Local Governments, and Non-Profit Organizations." The audit report guidance supplements that presented in Chapter 10, and applies to DCAA audits of all organizations covered by Circular A-133. This includes nonprofit organizations such as educational institutions and Federally Funded Research and Development Centers (FFRDCs).

13-702 OMB Circular A-133**13-702.1 General**

a. OMB Circular A-133 (see 13-207) establishes audit and reporting requirements for states, local governments, educational institutions, and other nonprofit organizations, and defines federal responsibilities for implementing and monitoring these requirements.

b. Circular A-133 requires auditors to issue reports on three parts of an auditee's operation: (1) financial statements, (2) internal control, and (3) compliance with laws and regulations. Pro forma audit reports developed by DCAA to meet the Circular's requirements for reporting on an auditee's internal control and program compliance are available through contacting either your regional representative cognizant of A-133 audits or Headquarters (PPD).

c. Related supplemental guidance for preparing DCAA audit reports is presented in the following sections of Chapter 10:

(1) Section 2 -- Audit Report Format and Contents (General),

(2) Section 4 -- Audit Reports on Operations and Internal Control (System Audits), and

(3) Section 5 -- Audit Reports on Annual Incurred Costs

13-702.2 Frequency of Audits

a. Circular A-133 audits shall be performed annually, except that biennial audits are permitted under limited circumstances. These conditions are presented in Subpart B section .220 of the Circular. DCAA's A-133 audit efforts are almost always performed annually.

b. When planning DCAA's part of the A-133 audit, the auditor needs to contact the auditee or cognizant agency for audit (see 13-102.3) to determine if a biennial audit has been approved, and if so, consider using a multi-year audit approach (see 6-603.6).

13-702.3 Audit Report Due Dates

a. Circular A-133 requires the auditee to submit its complete reporting package within 30 days after receiving all the audit reports or within 9 months after the end of the period audited, whichever comes first. However, the April 1997 version of OMB Circular A-133 Subpart C section .320 (a) allows for a two year transition period (this provision is effective for the fiscal years beginning after June 30, 1998) allowing entities to continue submitting their reporting package under the previous requirement i.e., 13 months after the end of the period audited. DCAA audit reports must be available to the auditee in time for the auditee to meet its reporting due dates.

b. Circular A-133 (Subpart D) authorizes the cognizant agency for audit or the oversight agency for audit (see 13-102.3) to grant auditee requests for extensions to the report due date.

13-702.4 Major Program Determination Using the Risk Based Approach

a. The Circular does not require auditors to test all federal programs; it requires the auditor to use a risk-based approach established by OMB in selecting major programs for testing. Circular A-133 ex-

tends compliance testing to all programs having internal controls tested as part of the 50 percent coverage rule (see 13-702.4c(4) below). The risk-based approach allows testing to be reduced to 25 percent if the auditee is considered low-risk (see A-133 section .520(f)).

b. For the auditor to determine which major programs are to be tested for compliance using the risk-based approach, the auditee must provide a schedule of expenditures of federal awards (see 13-706.4). Using the risk-based approach, the auditor will determine which federal programs are major programs taking into consideration:

(1) current and prior audit experience,
(2) the extent of oversight provided by federal agencies and pass-through entities, and

(3) inherent risk of the federal program.

c. A four step process for determining major programs using the risk-based approach is presented in Circular A-133 at Subpart E sections .520 and .525. A summary of the four step process follows:

(1) Designate programs as either type A (larger) or type B (smaller) based on total expenditures by the auditee during the audit period. Thresholds will vary by the size of the auditee's total federal expenditures and the criteria at A-133 section .520(b).

(2) Determine which of the type A programs are low-risk. Generally, a type A program is low-risk if it has been audited as a major program in at least one of the two most recent audit periods and, in the most recent audit period, had no reportable condition in internal control or reported material noncompliance with federal programs.

(3) Identify type B programs that are high risk. Using professional judgment and the criteria presented in 13-702.4b, evaluate risk. Only type B programs that meet OMB's size thresholds must be evaluated.

(4) Identify major programs for testing based on the results of the first three steps. Major programs will include all type A programs (except see A-133 section .520(e)); and additional programs as necessary so that the programs audited as major programs encompass at least 50 percent of the auditee's total federal expenditures.

The additional major programs selected to satisfy the percentage of coverage rule is based on the auditor's judgement.

d. When determining nature, timing, and extent of transaction testing of an auditee's compliance with laws and regulations, the auditor should consider audit risk and materiality related to each major program rather than the financial statements (see A-133 Subpart E section .510). Since materiality is evaluated at the program level rather than at the financial statement level, this will result in lower thresholds for judging materiality.

13-702.5 Major Program Determination – First Year Audit Exemption

Section .520(i) permits the auditor to use a dollar threshold rather than the risk based approach (13-702.4) in a first year audit. This exemption applies to the first year an auditee has an audit in accordance with the Circular dated June 1997, or the first year of a change in the auditee's independent public accountant. Under either condition, the auditor may elect to determine major programs as all Type A programs plus any Type B programs necessary to satisfy the percentage of coverage rule (see 13-702.4a above). The auditee may not use this exemption more than once in every three years. This is to ensure that constant change of independent auditors would not preclude the audit of high-risk Type B programs.

13-702.6 Compliance Supplement

The auditor should refer to the OMB Circular A-133 Compliance Supplement (see 13-208) to determine the principal compliance requirements for major programs. The document serves to identify the compliance requirements which the federal government expects to be considered as part of an audit. The Compliance Supplement provides a single source of information for auditors to understand the federal program's objectives, procedures, and compliance requirements relevant to the audit objectives as well as audit objectives and suggested audit procedures for determining compliance with these requirements. For programs not in the Com-

pliance Supplement, the auditor should first review the federal award and applicable regulations and then determine if a program-specific guide is available from the Office of the Inspector General of the federal awarding agency.

13-702.7 Program Specific Audit

a. A program specific audit is an audit of one federal program, rather than a single audit of the auditee's financial statements and federal programs. Section .200(c) of Circular A-133 states that when an auditee expends federal awards under only one federal program (excluding Research and Development (R&D)) and the federal program's laws, regulations, or grant agreements do not require a financial statement audit of the auditee, the auditee may elect to have a program-specific audit conducted in accordance with section .235 of the Circular. Program-specific audits are not permitted when an auditee is required to have a financial statement audit. An example of a program-specific audit that is not permitted is an award to an educational institution under the Student Financial Aid (SFA) program cluster. A program-specific audit is not permitted because the U.S. Department of Education regulations (Higher Education Act of 1965 as amended) require educational institutions with SFA to obtain an annual audit of financial statements.

b. A program-specific audit may not be elected for R&D program cluster unless:

(1) All of the federal awards expended were received from the same federal agency, or the same federal agency and the same pass-through entity, and

(2) That federal agency or pass-through entity (in the case of a subrecipient) approves in advance a program-specific audit. Although DCAA's audit covers the R&D program, DCAA generally issues single audit reports because the auditee typically receives federal awards from more than one federal agency or it is required to obtain a financial statement audit.

c. Before performing a program-specific audit, the auditor should determine whether the auditee satisfied the requirements identified above. Program-specific audit guides that provide guidance on in-

ternal control and compliance requirements, may be obtained by contacting the Office of the Inspector General of the awarding agency. For guidance on how to identify the applicable compliance requirements for program-specific audits when a program-specific guide is not available see section .235(b) of the Circular and Part 7 of the Compliance Supplement.

13-702.8 Monitoring Subrecipients

a. Pass-through entities (see Circular A-133 section .100) are required to monitor the activities of subrecipients. Monitoring a subrecipient includes on-site visits, review of documentation supporting request for reimbursement, and limited scope audits. The Single Audit Act Amendments of 1996 (see 13-103) prohibit a pass-through auditee from charging its federal awards the cost of an A-133 audit of a subrecipient when the amount of federal awards expended by the subrecipient is less than \$300,000 per year. However, Circular A-133 section .230(b)(2) does permit limited scope audits which includes agreed-upon procedures. The agreed-upon procedures may only address one or more of the following compliance requirements: activities allowed or disallowed; allowable costs/cost principles; eligibility; matching, level of effort, earmarking; and reporting.

b. For subrecipients that expend less than \$300,000 in federal awards annually, the costs of any audits other than limited scope audits described above, are not allowable costs and therefore, cannot be charged to any federal award.

c. Auditors should consider various risk factors regarding subrecipient monitoring, such as the relative size and complexity of awards administered by the subrecipient, prior experience with the subrecipient, and the cost-effectiveness of the various monitoring procedures identified above.

13-703 Coordinated Audit Approach

13-703.1 General

a. Under the conditions for receiving federal awards presented in Circular A-133, Subpart C, auditees agree to comply with applicable laws, regulations, and pro-

visions of the awards, and to maintain internal control which reasonably ensures compliance with these requirements. Subpart E describes the auditor's responsibility for establishing the audit scope and reporting the results of audit. Under OMB Circular A-133, audits are to be made by independent auditors in accordance with Government Auditing Standards. Section .105 of the Circular defines the term "auditor" to include federal, local, and state auditors, and the recipient's independent public accountant (IPA). The term "auditor" does not include the auditee's internal auditors. Section .305(c) of the Circular contains a provision permitting DCAA (federal) auditors to perform all or part of the work required under the Circular while operating within his/her federally mandated mission (see Chapter 1).

b. As provided for in Circular A-133, the auditee may elect to implement a coordinated audit approach. The objective of a coordinated audit is to avoid duplication of effort and build upon each other's work, but not to limit audit scope. As a result, the economies gained through mutual reliance will be achieved, and tests and procedures will not be duplicated.

c. DCAA's participation in a Circular A-133 audit will normally be on a coordinated basis; that is, there will be multiple organizations involved in the Circular A-133 audit process. The participants in a coordinated audit may include the auditee, its IPA and internal auditor, DCAA, the ACO, and the cognizant agency.

d. The coordinated audit participants should discuss and compare their individual audit/review requirements and identify areas of duplication. Participants should then agree on (and document) a coordinated audit matrix, the audit/review responsibilities of each party, which independent auditor will be responsible for reporting on the auditee's compliance with the applicable Circular A-133 compliance requirement(s), and finally, which independent auditor will be responsible for completing the applicable portions of the data collection form (see 13-706.7).

e. Because ACOs and internal auditors do not meet the definition of "auditor" as used by Circular A-133 (see section .105),

their reports do not conform to the audit reporting requirements of A-133 (see section .505). Therefore, either DCAA or the auditee's independent auditor must perform steps necessary to place reliance upon the ACO's and/or internal auditor's work and issue a comprehensive report in accordance with the Circular.

f. The DCAA auditor should endeavor to participate as a team member in ACO business system reviews (for example, a purchasing system). The auditor should ensure that the audit is sufficient in scope to be responsive to both the needs of the contract administration organization and adequate to satisfy the requirements of Circular A-133. This can best be accomplished by ensuring that the ACO participates in the initial coordinated audit meeting. When preparing the Circular A-133 reports, the auditor should make maximum use of any reports issued by the ACO or its designee.

13-703.2 Coordinated Audit Matrix

a. In a coordinated audit, the participants will identify and document their respective audit/review responsibilities. The documentation of each participant's responsibilities in a coordinated audit is accomplished by completing a Coordinated Audit Matrix (or a similar form). The form will ensure that all applicable compliance requirements are appropriately covered in the A-133 audit, and reported on accordingly. Typically, DCAA will report on internal control related to the administration of federal awards and compliance with applicable laws and regulations (see 13-706.1).

b. The implementation of the coordinated audit approach will generally proceed along the following line:

(1) An initial coordination meeting is held where the participants will identify and compare their individual audit/review requirements and identify areas of duplication. Out of this meeting will come a coordinated audit matrix identifying the Circular A-133 compliance requirements and other audits to be performed by the audit organizations. The matrix will also delineate the required audit coverage and estimated report dates. The matrix ensures

that all applicable compliance requirements are appropriately covered in the A-133 audit and that duplication of audit effort between the audit entities will be eliminated to the maximum extent feasible. See Figure 13-7-1 for an example of a coordinated audit matrix.

(2) With regard to the compliance requirements, the auditor should refer to Part 2 of the OMB Circular A-133 Compliance Supplement, to identify which of the 14 types of compliance requirements have a direct and material effect on each major program subject to audit. Because DoD's awards to A-133 covered auditees are typically R&D related, DCAA's audit responsibilities are generally in the R&D program area (see A-133 section .105). The scope of DCAA's portion of the typical A-133 audit will generally be limited to the requirements on the matrix for which DCAA is noted as the responsible audit organization.

(3) As part of the coordinated audit planning process, the participants in the coordinated audit should discuss, agree, and document on the coordinated matrix which independent auditors will be responsible for completing the applicable portions of the data collection form (see 13-706.8). The DCAA auditor should meet with the auditee and its independent auditors in an effort to persuade the auditee's IPA to complete Parts I (Item 7) and III of the data collection form. The DCAA auditor should use materiality as the persuading criterion for determining which audit organization will sign the data collection form. When the materiality of the financial statements audited by the auditee's IPA is compared to the materiality of the federal programs audited by DCAA, usually the auditee's IPA will have performed the major portion of the Circular A-133 audit work. For additional guidance on completion of the data collection form see 13-706.8.

(4) Following the development and acceptance of the matrix, the audits/ reviews will be performed by the respective coordinated audit participants.

(5) Auditors will make arrangements to obtain access to audit programs, working papers, and reports for the work being relied upon.

(6) Audits under Circular A-133 are to be completed and reports submitted to the auditee so that the auditee may submit its A-133 reporting package no later than 9 months (see 13-702.3) after the end of the institution's fiscal year. Participation in a coordinated audit approach requires ongoing audit planning and progress conferences to ensure that the individual audit plans will result in effective audits with minimal duplication.

13-703.3 Document Audit Scope Limitations

a. Situations that may constitute a limitation on the scope of DCAA's OMB Circular A-133 audit and thereby warrant the issuance of a qualified audit opinion or disclaimer of opinion include:

(1) An auditee received a significant amount in federal awards from a non-DoD agency, and the non-DoD agency is unwilling to reimburse DCAA for its portion of DCAA's OMB Circular A-133 audit services, or

(2) A significant amount of auditee expenditures for the period is excluded from the scope of DCAA's audit. For example, the DCAA auditors (including Field Detachment auditors) may not have access to certain restricted or classified information.

b. In those cases where there is both DoD and non-DoD business, and the non-DoD agency officially notifies DCAA that it will not reimburse DCAA or require DCAA audit services, the FAO should advise the non-DoD agency that its awards will not be included in DCAA's audit.

c. As part of the coordinated audit planning process, notify the auditee, its IPA, and the cognizant agency for audit that the non-DoD agency's federal awards will not be included in DCAA's audit. The participants in the coordinated audit should revise the coordinated audit matrix to reflect any change in audit responsibility for the non-DoD awards from DCAA to the IPA (or other independent auditor). Circular A-133 Subpart E. 500(a) requires that an A-133 audit cover the entire operations of the auditee. Therefore, if DCAA does not cover a particular federal program, the

IPA or another federal auditor must cover the program.

d. When the FAO and the Field Detachment have joint audit responsibilities, the objective should be to achieve a comprehensive, coordinated, and integrated audit of the recipient's federal expenditures. Annual coordination meetings should be held between the FAOs to determine the responsibilities of each FAO (see 6-405.4a).

e. In planning the audit, the regional FAO should assure that the auditee fulfills its reporting obligations under Circular A-133, which requires that the auditee prepare and submit to DCAA the schedule of expenditures of federal awards (A-133 section .310(b)). Upon receipt of this schedule, the regional FAO should verify that it is complete and determine if audit assistance is required. This may be accomplished by knowledge gained from prior audit experience with the auditee and through discussions with the auditee at the entrance conference. When it is determined that the regional FAO does not have access to federal awards because they are classified, audit assistance from the cognizant Field Detachment FAO should be requested.

f. There may be situations where audits of the classified awards are performed by another government audit organization similar to the Field Detachment. In all cases where classified work is involved, the regional FAO should request assistance from the Field Detachment. If necessary, the Field Detachment will then coordinate audit matters with the other government audit organization, and will perform procedures necessary for relying upon the work of other auditors (see 4-1006.2). The Field Detachment FAO will communicate the results of audit in an assist audit report to the regional field audit office.

g. When appropriate, the DCAA FAOs will rely on the work performed by other government audit organizations. If the work performed by the other auditor is material to the DCAA FAO's opinion being expressed, and the DCAA FAO is unable to rely upon the work performed by the other government audit organization, the FAO's audit report will exclude

those awards audited by the other government audit organization, contain a limitation on scope paragraph, and not make mention of the classified nature of the awards.

h. DCAA FAOs will rely on the work of other DCAA offices (including Field Detachment) without making reference to the work performed by that office in the audit report (refer to 4-1006.2b). The regional FAO must fully coordinate with the cognizant Field Detachment FAO regarding the manner in which any Field Detachment assist audit findings may be presented in the regional FAO's A-133 audit report. Consideration must be given to security concerns and the probable need to present the audit finding without reference to the classified nature of the awards, and without reference to the Field Detachment. Therefore, the information in the assist audit report should not be attached to the A-133 audit report.

13-703.4 Relation to Other Audit Requirements

a. Whether or not an FAO participates in a coordinated audit, audit planning and execution should consider the extent to which reliance can be placed on the work performed by the auditee's independent auditors. (See 4-1000 for guidance when relying upon the work of others).

b. An audit made in accordance with Circular A-133 is to be in lieu of any financial audit required under individual federal awards. Accordingly, to the extent that an A-133 audit provides an FAO with the information and assurances needed to carry out its overall responsibilities, the FAO is to rely upon and use such information. FAOs can make additional audits if needed to carry out their responsibilities under federal law and regulation. Such additional audits, however, must be planned and executed so that they build upon the work already performed under the A-133 audit.

c. The Circular does not limit the authority of DCAA to conduct audits and evaluations of federal awards, nor does it authorize any institution or subrecipient thereof to constrain DCAA, in any manner,

from carrying out additional audits or evaluations.

13-704 Audit of Internal Control

13-704.1 General - Internal Control

Circular A-133 requires the auditor to determine and report on whether the auditee's system of internal control provides reasonable assurance that the auditee is properly managing its federal programs.

13-704.2 Scope of Audit - Internal Control

a. Circular A-133 requires auditors to obtain an understanding of the auditee's internal control over federal programs, assess control risk, and perform appropriate testing of the internal control over major federal programs. The auditor relies on his/her understanding of the internal control to plan the compliance audit.

b. Circular A-133 does not require testing of the internal control in situations where the auditee's system of internal control is likely to be ineffective in preventing or detecting noncompliances. These situations are always reportable conditions. If the auditor limits his/her consideration of the internal controls for any reason, the circumstance should be disclosed in the audit report.

c. During the audit, the auditor may become aware of deficiencies in the design or operation of the internal control. These deficiencies may also be considered as reportable conditions. Paragraph 5.26 of the Government Auditing Standards provides examples of potential reportable conditions.

d. If a reportable condition is considered to be of such magnitude as to preclude management from asserting that the entity has effective internal control, it would be reported separately as a material weakness. The auditor should coordinate in advance with regional management and the auditee's independent public accountant before issuing an audit report citing the auditee for a material weakness.

13-704.3 Reporting - Internal Control

The report on the system of internal control will describe the scope of testing the internal control and the results of the tests. Generally, the auditor does not express an opinion on the overall internal control system because the procedures necessary to express an opinion are not performed (see 10-408e), but rather the auditor describes the extent of work performed.

13-705 Audit of Compliance

13-705.1 General - Compliance

Circular A-133 requires the auditor to determine and express an opinion on whether: (i) the auditee has complied with applicable laws and regulations, and (ii) any noncompliances found would have a material impact on major program(s) determined in accordance with the risk-based approach described in Subpart E of the Circular.

13-705.2 Scope of Audit - Compliance

a. The Circular states that compliance testing should include tests of transactions and such other auditing procedures necessary to provide the auditor sufficient evidence to support an opinion on compliance. When performing compliance tests the auditor is to:

(1) use the risk-based approach (see 13-702.4), to determine the major programs that are to be tested;

(2) identify the applicable compliance requirements using the compliance supplement and professional judgment (see 13-702.6);

(3) consider the auditee's internal control over compliance (see 13-704);

(4) perform compliance testing of transactions to obtain sufficient evidence to support an opinion on compliance for each major program; and

(5) perform follow-up procedures on previously reported findings (13-706.1c).

b. The principal compliance requirements applicable to most federal programs

are included in the compliance supplement. The supplement also contains the audit objectives for each type of compliance requirement and suggested audit procedures to be used by the auditor in developing an audit program for testing compliance. For those federal programs not covered in the compliance supplement, the auditor should audit provisions of the contracts and grant agreements, and use the types of compliance requirements contained in the compliance supplement as guidance for identifying the types of compliance requirements to test.

13-705.3 Reporting – Compliance

DCAA's pro forma audit report requires an opinion on the auditee's compliance with laws and regulations. It also calls for (i) an opinion on the auditee's schedule of federal expenditures, and (ii) a statement of concurrence/nonconcurrence regarding the auditee's summary schedule of prior audit findings.

13-706 Preparation and Distribution of Audit Reports and the Data Collection Form

This section discusses the overall reporting requirements of Circular A-133 and DCAA requirements governing audit report content and completion of the data collection form. Circular A-133 requires the auditee to prepare the financial statements, schedules (schedule of expenditures of federal awards, summary schedule of prior audit findings) and corrective action plan. The preparation of audit reports and schedule of findings and questioned costs are the responsibility of the independent auditor. The financial statements, schedules, corrective action plan and audit reports make-up the A-133 reporting package. Circular A-133 also requires the auditee and auditor(s) to complete and sign applicable portions of the data collection form.

13-706.1 Three Parts of Auditees' A-133 Reporting Package

a. The required Circular A-133 reports covering a particular fiscal year are packaged together by the auditee into a Circular

A-133 audit "reporting package." This reporting package, when complete, is forwarded by the auditee to a federal clearinghouse. The reporting package can include audit reports from a federal audit organization, as well as reports from the auditee's independent public accountant in a coordinated audit approach. To satisfy the Circular's reporting requirements, auditor(s) will normally issue the following reports:

(1) Report(s) on Financial Statements & Schedule of Expenditures of Federal Awards. This report calls for an opinion on whether the financial statements are presented fairly in all material respects in conformity with GAAP, and an opinion on whether the auditee's schedule of expenditures of federal awards is presented fairly in relation to the financial statements taken as a whole. These opinions may be expressed in a single or two separate reports. Audit reports on financial statements are always the responsibility of the IPA. The "Results of Audit" section in DCAA's Circular A-133 audit report includes an opinion on the auditee's schedule of expenditures of federal awards. (See 13-706.4)

(2) Report(s) on internal control and compliance over financial reporting based on an audit of the financial statements in accordance with the Government Auditing Standards. This is a report on the auditor's understanding of the auditee's system of internal control which includes a description of the scope for testing of internal control and the results of the tests. This report is the responsibility of the IPA.

(3) Report(s) on internal control and compliance with requirements applicable to each major program in accordance with Circular A-133. This report provides the auditor's opinion on whether the auditee complied with applicable laws, regulations and provisions of its federal awards. Depending on the coordination between the independent auditors, the report(s) on internal control and compliance can be the responsibility of DCAA, or both DCAA and the IPA.

b. Subpart E section .505 of the Circular permits the three parts of an A-133 reporting package (financial, internal control,

and compliance) to be combined or presented as separate reports.

c. In addition to the three parts of a Circular A-133 report, the auditee must also submit the following as part of its A-133 reporting package:

(1) Schedule of Findings and Questioned Costs -- Subpart E section .505(a)(4) requires a summary of the audit findings and questioned costs. This is a summary of the results of audit. (See 13-706.5)

(2) Summary Schedule of Prior Audit Findings -- Subpart C section .315(b) requires the auditee to report on the status of all audit findings included in the prior audits. Circular A-133 requires the auditor to follow-up on corrective actions taken by the auditee related to prior audit findings. Corrective action in Circular A-133 means action taken by the auditee that: (i) corrects identified deficiencies, (ii) produces recommended improvements, or (iii) demonstrates that the audit findings are either invalid or do not warrant auditee action. The auditor assesses the reasonableness of the auditee's assertions regarding the status of previously reported findings. After completing the assessment, the auditor then reports as a current year audit finding, assertions prepared by the auditee that materially misrepresent the status of any prior audit finding. (See 13-706.6)

(3) Corrective Action Plan -- Subpart C section .315(c) requires the auditee to prepare a corrective action plan to address each audit finding. The plan should include a point of contact, corrective action to be taken, and anticipated completion date. The DCAA auditor will consider the auditee's corrective action plan when presenting the audit finding.

(4) Data Collection Form -- Although not part of the auditee's reporting package, Subpart C section .320(b) requires the auditee and auditor(s) to prepare a data collection form at the completion of the audit and submit it to a federal clearinghouse designated by OMB along with the reporting package. (See 13-706.8)

13-706.2 Report Format and Content

a. Prepare the Circular A-133 report using the pro forma report for internal con-

trol and compliance (13-702.1). Address the report to the cognizant agency for audit and provide concurrent copies to the auditee for inclusion in its reporting package to be submitted to the federal clearinghouse.

b. The audit findings (e.g., internal control deficiencies and noncompliance findings) should be presented in sufficient detail for the auditee to prepare a corrective action plan and allow resolution of the finding. As noted in section .510(b) of the Circular, at a minimum, the elements of an audit finding will include:

(1) Condition - facts relied on that indicate that a noncompliance occurred;

(2) Criteria - including regulatory, statutory, or other citation; information to provide proper perspective for judging the prevalence and consequences of the audit findings; and where appropriate, instances of noncompliance shall be related to the universe and the number of cases examined;

(3) Recommendation - corrective action to prevent future occurrences of the deficiency;

(4) Auditee reaction - pertinent views of responsible officials of the audited entity;

(5) Auditor's response - if viewed as appropriate; and

(6) Reference number - each audit finding is to include a reference number to allow for easy referencing by the auditee in preparing both the current year corrective action plan, and the summary schedule of status of prior audit findings. To avoid confusion, the DCAA auditor should coordinate with the IPA and agree on each audit organization using a different audit reference numbering scheme.

c. For A-133 reporting purposes, the auditor is required to report as audit findings in the schedule of findings and questioned costs:

(1) questioned cost greater than \$10,000 for a type of compliance requirement for a major program (A-133.510(a)(3)), and

(2) questioned costs greater than \$10,000 for a federal program which is not audited as a major program (A-133.510(a)(4)).

The auditor is not prohibited from reporting as an audit finding questioned costs that are less than the above thresholds. The auditor will exercise judgment and report each audit finding considered to be material under the given circumstances.

13-706.3 Limitation of Audit Scope

a. Restrictions on the scope of the DCAA field audit office's work on compliance may require the auditor to express a qualified opinion or disclaim an opinion (see 13-703.3). For example, the circumstances may be that DCAA's portion of the coordinated audit of federal programs does not include the entirety of the auditee's federal awards, the excluded awards are significant, and the exclusions impact the auditee's ability form an overall opinion on compliance over the federal program(s). These circumstances may occur when a non-DoD agency does not have the funds to reimburse DCAA for audit services, or when the Field Detachment is precluded from applying all the procedures considered necessary to rely on the work of another government audit organization. In such cases DCAA's audit report will be revised as follows:

(1) The non-DoD awards will not be identified in DCAA's audit report and the other documents accompanying DCAA's Circular A-133 audit report;

(2) The circumstances should be identified in a separate paragraph of DCAA's Circular A-133 audit report(s), however, no mention will be made that any awards are classified;

(3) Both the Scope and Results of Audit paragraphs in the audit report should specifically refer to this limitation on scope, and the audit opinion will refer only to those awards listed in DCAA's audit report.

b. In those situations where it is not clear whether or not the regular DCAA office should report audit findings that may also affect classified work because of security concerns, the matter should be elevated to management for resolution. In all circumstances, the auditee should be made aware of audit findings that affect classified awards.

13-706.4 Reporting on Schedule of Expenditures of Federal Awards

a. There are over 1,000 individual grant programs and several types of federal awards. Many of the major programs are identified by their catalog of federal domestic assistance number (CFDA number, see A-133, Subpart 105). Circular A-133, section .310 requires the auditee to prepare a schedule of expenditures of federal awards along with notes that describe significant accounting policies used in preparing the schedule. For the R&D program, total federal awards expended shall be shown either by individual award or by federal agency and major subdivision within the federal agency.

b. The purpose of reporting on the schedule is to present a summary of the auditee's total expenditures by major program, non-major program, and non-cash assistance (i.e., programs involving commodities received, loan guarantees, loans, or insurance). A-133 section .505(a) requires the auditor to express an opinion on whether the schedule of federal awards is presented fairly in all material respects in relation to the financial statements. Typically, DCAA will comment on the research and development program. DCAA's pro forma Circular A-133 report will satisfy this requirement.

13-706.5 Schedule of Findings and Questioned Costs

a. Circular A-133, section .505(d) requires that each audit organization's audit report include a schedule of findings and questioned costs. This schedule is required even if there are no current year audit findings. Figure 13-7-2 is an example of a completed schedule for a typical DCAA A-133 coordinated audit.

b. If the IPA's participation in the A-133 coordinated audit results in the IPA serving as the principal auditor by accepting responsibility for DCAA's work insofar as that work relates to the IPA's expression of an opinion, there will normally be a single schedule. This schedule will appear in the IPA's audit report. The participants in the coordinated audit should discuss,

agree, and document how their respective audit findings will be presented in this schedule.

c. In all A-133 audits, the DCAA field audit office will complete the schedule and include at a minimum, the information relative to the scope of the DCAA auditor's work. When the following two conditions are met, the information in DCAA's schedule of findings and questioned costs will be incorporated in the schedule that the auditee's IPA prepares:

(1) the IPA's participation in the A-133 coordinated audit results in the IPA serving as the principal auditor, and

(2) the IPA assumes responsibility for the work of DCAA insofar as that work relates to the IPA's expression of an opinion.

d. The schedule is prepared by the auditor(s) and is comprised of the following three sections: Section 1, Summary of Auditor's Results; Section 2, Findings Related to the Financial Statements; and Section 3, Findings Related to Federal Awards.

(1) Section 1 -- Summary of Auditor's Results (Circular A-133 section .505(d)(1)). This section of the schedule includes information relative to both the audits of the financial statements and the federal awards. The IPA should include information relating to the financial statement in their schedule, since this area is beyond DCAA's audit mission. However,

audit findings that relate to both the financial statements and federal awards should also be included in Sections 2 and 3 of the schedule. For example, a reportable condition that is a material weakness in the auditee's internal control may affect the auditee's financial statements and federal awards. With respect to DCAA's reporting responsibilities, the auditor should coordinate each finding with the IPA. If DCAA's audit procedures result in an audit finding (as defined in A-133 section .510(a)), the DCAA auditor will disclose in Section 1 that an audit finding exists and report the finding in detail in the federal awards part of Section 3 of the DCAA prepared schedule. If appropriate, the IPA may note a finding exists in Section 1A and summarize the audit finding in the financial statement part of Section 2 of the IPA prepared schedule. The IPA should cross reference to the detailed audit finding number contained in DCAA's audit report. Circular A-133 section .505(c) requires that each audit finding include a reference number (see 13-706.2b(6)). A suggested format is to precede the note number with the last two digits of the auditee fiscal year reported, for example fiscal year 1998 notes may read, 98-1, 98-2 and so on.

The information required by the Circular to be included in Section 1 of the schedule and the parties responsible for this information are presented in the following table:

Section 1. – Summary of Auditor’s Results	IPA	DCAA
PART A. The type of report issued on the financial statements of the auditee (i.e., unqualified opinion, qualified opinion, adverse opinion, or disclaimer of opinion.) (See Circular A-133 §.505(d)(1) (i).)	X	
When applicable, a statement that reportable conditions in internal control were disclosed by the audit of the financial statements and whether any such conditions were material weaknesses (see Circular A-133 §.505(d)(1) (ii)).	X	
A statement on whether the audit disclosed any noncompliances that are material to the financial statements (see Circular A-133 §.505(d)(1) (iii)).	X	
PART B.1. When applicable, a statement that reportable conditions in internal control over major programs were disclosed by the audit and whether any such conditions were material weaknesses (see Circular A-133 §.505(d)(1) (iv)).	X	X
PART B.2. The type of report the auditor issued on compliance for major programs (i.e., unqualified opinion, qualified opinion, adverse opinion, or disclaimer of opinion), (see Circular A-133 §.505(d)(1) (v)).	X	X
PART B.3. A statement on whether the audit disclosed any audit findings that the auditor is required to report under section .510(a), (see Circular A-133 §.505(d)(1) (vi)).	X	X
PART B.4. Identification of major programs (see Circular A-133 §.505(d)(1) (vii)).	X	X
PART B.5. The dollar threshold used to distinguish between type A and B programs as described in section .520(b) of the Circular, (see Circular A-133 §.505(d)(1) (viii)).	X	X
PART B.6. Statement as to whether the auditee qualified as low risk under section .530 of the Circular, (see Circular A-133 §.505(d)(1) (ix)).	X	X

(2) Section 2, Findings Related to Financial Statements (Circular A-133 section .505(d)(2)). As noted above, audit findings that relate to the financial statements are the responsibility of the IPA. DCAA’s schedule will refer the reader to the IPA’s audit report(s).

(3) Section 3, Findings Related to Federal Awards (Circular A-133 section .505(d)(3)). Information in Section 3 of the schedule provides the detail findings of compliance. This section is somewhat similar to the format used in DCAA’s annual incurred cost audit report exhibit(s) and supporting schedules. See 13-706.2 for the audit finding details to be included in this section.

13-706.6 Summary Schedule of Prior Audit Findings

a. The auditee is required to prepare and submit a “summary schedule of prior audit findings” (see 13-706.1c(2)) presenting the status of corrective action taken on all audit findings included in the prior audit report. In addition, at the completion of the current year’s audit and prior to issuance of the final audit report(s), the auditee is required to:

(1) evaluate the current year audit findings;

(2) determine proper actions in response to these findings; and

(3) prepare a written response on each finding, referred to as a “corrective action plan.”

b. The auditor is required to comment on the accuracy of the auditee's required statements, responding to both the corrective action taken by the auditee on prior and current year findings. The summary schedule of prior audit findings and the corrective action plan for the current year are requirements of Circular A-133. Because they contain material necessary for the reader to obtain a full understanding of the circumstances, both the schedule and action plan should be included as appendixes to DCAA's audit report.

13-706.7 Report Distribution and Restrictive Markings

a. DCAA's Circular A-133 audit reports on internal control and compliance are addressed to the cognizant agency for audit, with the auditee listed on the distribution list. There is no need to distribute the audit report to other federal agencies since this is the responsibility of the federal clearinghouse and auditee. See section .320(d), (f), and (h) of Circular A-133 and 10-206 for additional guidance.

b. In contrast with DCAA audit reports on a for-profit contractor, the Circular A-133 reports are available for public inspection (see A-133 section .320(a)). To avoid public confusion regarding FOUO markings and audit report distribution and restrictions (see 10-212), DCAA's Circular A-133 pro forma reports have been modified to satisfy the A-133 requirement that they be available for public review.

c. The auditor will issue DCAA's Circular A-133 audit reports (see 13-702.1) including the For Official Use Only (FOUO) markings to comply with DoD FOIA regulations. However, the auditor will furnish the auditee an electronic version of its A-133 audit reports, and advise the auditee that it should remove the FOUO restrictions from the DCAA audit reports prior to their incorporation into the Circular A-133 reporting package. Figure 13-7-3 is an example of the "Restrictions" page which must be incorporated into Circular A-133 audit reports prepared by DCAA auditors. The "restrictions" language defines FOUO markings, authorizes

the auditee to release the audit report to the public, and authorizes the auditee to remove the FOUO markings from the audit report.

d. DCAA's reports are largely based on procedures from the Compliance Supplement. Audit reports include language stating that the audit report is a restricted-use report, and should not be used by anyone other than the intended parties specified in the audit report. The Audit Report Distribution and Restrictions page includes language to comply with Statement on Auditing Standards (SAS) No. 87, Restricting the Use of An Auditor's Report. A restricted-use report is one that is intended only for specified parties.

e. The auditee submits its complete audit report package to a federal clearinghouse designated by OMB. The federal clearinghouse is responsible for retaining a copy of the report package for records, distributing the report package to federal funding agencies and pass-through entities, and maintaining a database with information on each auditee.

13-706.8 Data Collection Form

a. Both the auditee and auditor(s) complete and sign applicable sections of the data collection form (Form No. SF-SAC) at the completion of the audit, regardless of whether findings and questioned costs were noted. The data collection form provides summary information about the auditee, its federal programs, and the results of audit. Using information on the data collection form, the federal clearinghouse maintains a database of A-133 audit results, which is used to followup with auditees who have not submitted the required data collection form and reporting package. The clearinghouse also distributes the reporting packages to those federal awarding agencies for which an audit finding is included in the package's schedule of findings and questioned costs.

b. The types of information required by the data collection form and the parties responsible for this information are presented in the following table:

Part No./ Title	Part Description	Auditee	IPA	DCAA
I. General Info	Identifies affected fiscal year, type of audit, employer identification number, and federal cognizant or oversight agency.	X		
I. Item 6 - Auditee Info	Provides organizational information about the auditee. Auditee signs a certification of completeness and accuracy.	X		
I. Item 7 - Auditor Info	Provides organizational information about the IPA. Auditor(s) sign(s) a statement on completeness.		X	X
II. Financial Statements	Provides information on the type of audit and reported results. (Generally, the IPA will be responsible for completing this part, since this area is beyond DCAA's audit mission.)		X	(X)
III. Federal Programs	Information on the type of audited federal program, information on the audit and audit results, identification of federal agencies required to receive audit reporting packages, and a summary of audit results by program.		X	X

c. The auditor is required to complete Parts I (Item 7), II, and III. Part I (Item 7) is a statement signed by the auditor. The signed statement indicates: the auditor's responsibility for the information on the form, the form is not a substitute for the A-133 audit reports, the data elements and information on the form are limited to those prescribed by OMB, and no additional audit procedures were performed since the date of the audit reports. Part II provides information about the financial statements, and Part III provides information about the results of audit as they pertain to federal programs. Auditors may not create their own electronic version of the form.

d. Since DCAA's participation in a Circular A-133 audit will normally be on a coordinated audit basis (see 13-703), there will be multiple audit organizations involved in providing information needed to complete the data collection form. DCAA auditors are to coordinate completion of the form with the IPA. This is best accomplished at the inception of the coordinated audit planning process. The DCAA auditor's responsibility regarding completion of the data collection form

should generally be limited to entering the results of his or her audit into Part III, federal programs. To accomplish this the DCAA auditor should meet with the auditee's IPA to persuade the IPA to be the "lead or coordinating auditor," and accept responsibility for completing Parts I (Item 7), II, and III of the data collection form. The DCAA auditor should use materiality as the criterion for determining which audit organization will be the "lead or coordinating auditor" which signs the data collection form. Comparing the materiality of the financial statements (and federal programs if applicable) audited by the IPA to the materiality of the federal programs audited by DCAA, typically the IPA will have performed the major portion of the Circular A-133 audit work. If the IPA concludes that DCAA should be the "lead or coordinating auditor," the DCAA auditor should coordinate this matter with his or her field audit office (FAO) manager before accepting the responsibilities.

e. Completing Part I. If the IPA's participation in the A-133 coordinated audit results in the IPA serving as the principal auditor, and the IPA assumes responsibility

for the work of DCAA insofar as that work relates to the IPA's expression of an opinion, the IPA should be designated as the lead auditor for purposes of completing the data collection form. The IPA should complete Parts I (Item 7), II, and III of the data collection form. In all cases, the DCAA auditor should attach a sheet to the data collection form with the same type of information provided by the IPA for Part I Item 7. In addition, if agreed as part of the coordinated audit planning process, the FAO manager may also sign the auditor statement in Item 7.

f. The IPA and DCAA may decide that a clear division in audit and reporting responsibility exists. If the IPA decides not to serve as the lead auditor, the DCAA auditor may agree to serve as the lead auditor and the FAO manager will complete and sign Item 7. However, to indicate the division of responsibility, the IPA must agree to also sign Part I and attach a sheet to the data collection form with the same information provided by DCAA. The sheet should identify the division of audit and reporting responsibility.

g. Completing Part II. The information for completing Part II is obtained from the audit reporting on the financial statements only. Generally, the IPA will be responsible for completing Part II, since this area is beyond DCAA's audit mission. However, if the DCAA auditor agrees to serve as the lead or coordinating auditor, then the DCAA auditor working with the IPA may complete this section of the form.

h. Completing Part III. In all coordinated audits, the FAO will either complete or, when requested, assist the IPA in completing Part III of the form for those programs audited by DCAA. Auditors are not permitted to include a photocopy of the auditee's Schedule of Expenditures of Federal Awards as a substitute for completing this section of the data collection form. If additional pages are needed to complete this part, photocopy page 3 of the data collection form, attach the additional pages to the form, and enter the total for all pages in the "Total Federal Awards Expended" block on the last page.

i. The data collection form instructions for Part III, Item 6 (a) and (b) require the

auditor(s) to enter the number assigned to the federal program in the Catalog of Federal Domestic Assistance (CFDA). Since the research and development cluster program does not have a CFDA number, the auditor(s) enter the federal agency's two-digit prefix, followed by a period and the letters "RD." For example, a DoD research and development program would be entered as "12.RD" under column (a). For other programs that do not have a CFDA number, auditors should enter only the federal agency's two-digit prefix. For a list of federal agency two-digit prefix numbers, see the Appendix to the instructions for completing the data collection form. Also, auditors are to enter the amount of expenditures (Part III, Item 6(c)) from the auditee's Schedule of Expenditures of Federal Awards for each federal program. For guidance on the Schedule see Circular A-133 §.310(b) and 13-704. The CFDA catalog is compiled and published annually by the General Services Administration and may be accessed electronically at the site: <http://www.gsa.gov/fdac/>.

j. Item 7 requires the auditor to enter information regarding audit findings and questioned costs. This information is taken from the Schedule of Findings and Questioned Costs, prepared by the auditor as part of the audit report. Using the two-digit prefix discussed above the auditor must identify audit findings for each federal agency within the R&D cluster program. To assist DCAA auditors, a matrix (see Figure 13-7-4), summarizes the information in the audit report to facilitate completion of Part III, Item 7 of the data collection form. The matrix accumulates questioned costs by compliance requirement for each federal program to be entered onto the data collection form. The matrix also serves as a tool to assist federal departments to resolve audit findings and recommendations affecting their awards. The matrix at Figure 13-7-4 is a suggested format that should clarify the relationship between the explanatory notes in the audit report and the audit reference numbers in the data collection form. The matrix or a similar document is to be included as the last page to DCAA's Schedule of Findings and Ques-

tioned Costs in DCAA's Circular A-133 audit report.

k. Instructions and the data collection form may be obtained from:

(1) OMB's fax information line, (202) 395-9068, document no. 1330;

(2) OMB's web site located at: <http://www.whitehouse.gov/WH/EOP/OMB/Grants/sfac.pdf>;

(3) Federal audit clearinghouse: phone no. (888) 222-9907, document no. SF-SAC;

(4) Federal audit clearinghouse web site: <http://harvester.census.gov/sac>. This site has an electronic template (Microsoft Word) containing four documents that may be downloaded. This approach permits the auditor to complete the form using a computer.

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Figure 13-7-1

Figure 13-7-1
Example Of Circular A-133 Coordinated Audit Matrix Identifying Compliance
Requirements of ABC Nonprofit Organization
CFY 19XX

Date Completed _____

Program Types of R&D Compliance Requirements (Refer to Compliance Supplement, Parts 2&3)	Compliance Requirement that is Applicable, and May have a Material Effect on Major Program (Y,N, or N/A)	Organization Accepting Responsibility for Providing Audit and Auditor Accepting Responsibility for Providing Reporting Coverage (Internal Control and/or Compliance Audit)			Addtl. Comments
		Independent Public Accountant	DCAA	Other (Identify organization)	
A. Activities Allowed or Unallowed					
B. Allowable Costs/Cost Principles					
C. Cash Management					
D. Davis-Bacon Act					
E. Eligibility					
F. Equipment and Real Property Management					
G. Matching, Level of Effort, Earmarking					
H. Period of Availability of Federal Funds					
I. Procurement and Suspension and Debarment					
J. Program Income					
K. Real Property Acquisition and Relocation Assistance					
L. Reporting					
M. Subrecipient Monitoring					
N. Special Tests & Provisions					
Other (list as applicable)					

Y: denotes requirement is applicable and will be included in audit scope.
N: denotes requirement is applicable, however, it may not have a direct and material effect of the major program.
N/A: denotes requirement is/is not applicable and will not be included within current year audit because (provide explanation in Additional Comments – for example, the specific requirement does not have a direct and material impact on the R&D program, see working paper XXX for documentation supporting assessment).

Point of Contact:

Auditee _____
Independent Public Accountant _____
DCAA _____
Other _____

Figure 13-7-2
Illustration
Schedule Of Findings And Questioned Costs

ABC NONPROFIT ORGANIZATION
Fiscal Year Ended September 30, 1998

SECTION 1: -- SUMMARY OF AUDITOR'S RESULTS**A. Financial Statements:**

Information pertaining to the financial statements can be found in the independent public accountant's audit report.

B. Federal Awards:**1. Internal control over major programs:**

	YES	NONE REPORTED
Material weaknesses were identified.	X	
Reportable conditions identified not considered to be a material weakness.	X	

2. Type of auditor's report issued on compliance for major programs:

Type of Audit Opinion	
Unqualified	X
Qualified	
Adverse	
Disclaimer	

3. Any audit findings disclosed that are required to be reported in accordance with Circular A-133, Section .510(a):

Yes	X
No	

4. Identification of Major Programs:

CFDA Number	Program
N/A	Research and Development

5. Dollar threshold used to distinguish between low and high-risk pools.

\$ 385,000

6. Auditee classified as a low-risk auditee under Circular A-133, Section .530.

Yes	
No	X

SECTION 2: -- FINDINGS RELATED TO FINANCIAL STATEMENTS

Information pertaining to the financial statements can be found in the independent public accountant's audit report.

SECTION 3: -- FINDINGS RELATED TO FEDERAL AWARDS

ILLUSTRATION
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
ABC NONPROFIT ORGANIZATION
Fiscal Year Ended September 30, 1998

OVERHEAD EXPENSES AND RATE

Questioned Costs (Note 98-X)						
Cost Element	Proposed	Total	Concurred	Non-concurred	Notes	Page
Rent & Occu- pancy Costs	\$ XXXX	\$XXXX	\$XXX	\$	98-X	X
Employee Mo- rale	XXXX	XXX	XX	XXX		
Subtotal	\$XXXXXX	\$XXXXXX	\$XXX	\$XXX		
Less:						
Voluntary Deletions	(XXX)	_____	_____	_____		
Totals	<u>\$XXXXXX</u>	<u>\$XXXXXX</u>	<u>\$XXXX</u>	<u>\$XXX</u>		
Allocation Base (Total Direct Labor Dollars):						
Proposed and Accepted:	\$XXXXXX					
Research Overhead Expense Rate:						
Proposed	70.02%					
Questioned	3.28%					
Audit Recommended	<u>66.74%</u>					
Concurred	<u>2.79%</u>					
Nonconcurrent	<u>.49%</u>					

Explanatory Notes:

98-X. Rent and Occupancy Costs

- a. Condition:
- b. Criteria:
- c. Recommendation:
- d. ABC's Reaction:

[The above example provides one note explaining the questioned costs in the schedule of findings and questioned costs. The details of the explanatory notes are excluded from this illustration.]

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Figure 13-7-3

Figure 13-7-3
Audit Report Distribution and Restrictions

Audit Report No. XXXX-XX169000XXX

AUDIT REPORT DISTRIBUTION AND RESTRICTIONS

DISTRIBUTION

[List names and addresses as shown on cover page, as well as any other names and addresses to which the report is being distributed.]

ABC Nonprofit Organization
6000 Chestnut Boulevard
Philadelphia, PA 19106-4498

E-mail Address

RESTRICTIONS

1. The For Official Use Only (FOUO) marking placed on this audit report is not a security marking. It is a marking required by DoD Freedom of Information Act (FOIA) regulations. The marking provides notice that the report might contain information that is subject to withholding under FOIA. The FOUO marking is a notice limited to Department of Defense employees.
2. The Defense Contract Audit Agency has no objection to the auditee releasing this report at its discretion for public inspection.
3. The Defense Contract Audit Agency has no objection to the auditee removing the FOUO markings from this audit report.
4. This report is intended solely for the information and use by federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

FOR OFFICIAL USE ONLY

**Figure 13-7-4
Illustration
Matrix Reconciling Audit Findings From DCAA's Audit Report to the
OMB Data Collection Form (Form No. SF-SAC) part III, Item 7**

Questioned Costs by Federal Program							
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Type of Compliance Requirement	DCAA Audit Report Explanatory Note No.	Cumulative Questioned Costs	Govt Participation in Questioned Costs	DoD R&D 12.R&D	HHS R&D 93.R&D	DoT 20.205	DoI 15.605
A Activities allowed or unallowed							
B Allowable costs/cost principles	98-1, 98-2, 98-4, 98-7, 98-8, 98-9	\$70,227	\$42,136	\$19,382	\$9,691	\$11,798	\$1,265
C Cash management							
D Davis-Bacon Act							
E Eligibility							
F Equipment and real property management	98-3	4,000	2,400	1,104	552	672	72
G Matching, level of effort, earmarking	98-5	3,250	1,950	898	448	546	58
H Period of availability of funds							
I Procurement							
J Program Income							
K Real property acquisition and relocation assistance							
L Reporting							
M Subrecipient monitoring							
N Special tests and provisions	98-6	20,000	20,000		20,000		
TOTAL		\$97,477	\$66,486	\$21,384	\$30,691	\$13,016	\$1,395

This matrix is a reconciliation of the questioned costs in the audit report to the related questioned costs in the Data Collection Form. The questioned costs from the audit report's schedule of findings and questioned costs are grouped by type of noncompliance with a specific compliance requirement in column (1). The cumulative questioned costs in column (3) are shown as they relate to each impacted federal program by compliance requirement and then factored for the government participation in column (4). These individual program impacts in column (4) are then entered on the Data Collection Form Part III, Item 7(e).

The cumulative questioned costs in column (3) are factored down for the government participation, as shown in column (4). In this example, the overall government participation in indirect costs for federal financial assistance and federal reimbursement contracts is 60%. The amounts in column 4 is factored further for each federal program. In this example the estimated federal program participation in the indirect costs by compliance requirement column (4), are DoD R&D 46% column (5); Health and Human Services (HHS) R&D 23% column (6); Dept. of Transportation (DOT) 28% column (7); and Department of Interior (DOI) 3% column (8). The noncompliances with the Special tests and provisions" compliance requirements row N is applicable only to HHS as a direct cost noncompliance. Supporting detailed computations are to be maintained in the auditor's working papers.

**13-800 Section 8 --- Office of Management and Budget (OMB) Circular A-122
"Cost Principles for Nonprofit Organizations," and Related Areas for Audit
Consideration**

13-801 Introduction

a. This subsection introduces Office of Management and Budget (OMB) Circular A-122 "Cost Principles for Nonprofit Organizations." For guidance on audits at educational institutions see 13-100 through 13-700.

b. The cost principles described in this chapter and contained in OMB Circular A-122 should be used in conjunction with the guidance contained in other sections of this manual for reviewing specific areas of cost at applicable nonprofit organizations. A current copy of OMB Circular A-122 should be available at each field audit office (FAO). The most recent version is dated June 1, 1998, and is a recompilation of the original and all subsequent amendments. FAOs which do not have a current and complete copy should contact the regional office. When planning the audit, the auditor must ascertain the implementation dates for the specific revised Circular A-122 provisions and adjust the scope accordingly.

13-802 Definition

Section 4 of OMB Circular A-122 defines "nonprofit organization" as any corporation, trust, association, cooperative, or other organization which:

- is operated primarily for scientific, educational, service, charitable, or similar purposes in the public interest;
- is not organized primarily for profit; and
- uses its net proceeds to maintain, improve, and/or expand its operations.

Excluded from this definition are (1) colleges and universities; (2) hospitals; (3) state, local and federally-recognized Indian tribal governments; and (4) other nonprofit organizations which because of their size and the nature of their operations are considered similar to commercial concerns.

13-803 Cost Principles

a. OMB Circular A-122. This Circular establishes principles for determining costs of grants, contracts and other agreements with nonprofit organizations as defined by the Circular (see 13-802). The principles do not apply to awards under which an organization is not required to account to the government for actual costs incurred. Provision for fee or other increment is not addressed by Circular A-122.

b. FAR Subpart 31.2. Those nonprofit organizations covered by 13-802(4) above are subject to Federal cost principles applicable to commercial concerns, i.e., FAR Subpart 31.2. Attachment C of Circular A-122 contains a listing of these nonprofit organizations, although other organizations may be added from time to time. Contracts and grants which refer to FAR Subpart 31.7 for determining allowable costs will have the allowability of costs determined by OMB Circular A-122.

c. Cost reimbursable subawards (i.e., subgrants, subcontracts, etc.) are subject to the Federal cost principles applicable to the organization to which they were awarded. Thus, for subawards to nonprofit organizations, OMB Circular A-122 applies; for subawards to commercial organizations, the cost principles applicable to commercial concerns apply; for subawards to colleges or universities, OMB Circular A-21 applies; and for subawards to State, local or federally recognized Indian tribal governments, OMB Circular A-87 applies.

13-804 Basic Audit Approach

a. The same basic audit approach described in the other chapters of this manual is to be applied to nonprofit organizations. Audit problems specific to nonprofit organizations not adequately covered in other sections of this manual may be referred to Headquarters, DCAA (Attn: PPD).

b. OMB Circular A-122, Attachment A, Section A.2.e., requires the nonprofit organization to compute allowable costs in

accordance with Generally Accepted Accounting Principles (GAAP). To be compliant with GAAP, a nonprofit's incurred cost submission usually has to be based on accrual accounting. GAAP allows the use of cash basis accounting only if the nonprofit organization demonstrates that the results of the cash basis do not differ significantly from the results of the accrual basis. It is the responsibility of the nonprofit (not the auditor) to make this demonstration.

13-805 Indirect Cost Rates at Nonprofit Organizations

13-805.1 Types of Indirect Cost Rates

a. Circular A-122, Attachment A, Section E, permits various types of indirect cost rates at nonprofit organizations. The types of rates are (1) predetermined rates, (2) fixed rates, (3) final rates, and (4) provisional rates.

b. Predetermined rates. A predetermined rate is an indirect cost rate fixed for an applicable period and generally, once negotiated, it is not subject to audit adjustment. The use of predetermined rates is appropriate when there is reasonable assurance, based on past experience and reliable projection of the nonprofit's costs, that the indirect rate is not likely to exceed the nonprofit's actual costs. Predetermined rates should not be used by those nonprofit organizations experiencing significant fluctuations in their rates from year to year.

c. Fixed rates. A fixed rate is similar to a predetermined rate, except that the difference between the estimated costs and the actual costs of the period covered by the rate is carried forward as an adjustment to the rate computation of a subsequent period. Fixed rates require two separate negotiation cycles; one to establish the fixed rate at the beginning of the period, and one to determine the final rate after the end of the period. A negotiated fixed rate should not be used when, (1) all or most of the federal awards will expire before the carry-forward adjustment can be made, (2) the government's participation in indirect costs fluctuates greatly from year to year, (3) the business base fluctuates significantly from year to year, or (4) a carry forward adjust-

ment may not be equitable because of significant changes in accounting practices.

d. Provisional and final rates. A provisional rate is an indirect cost rate applicable to the period which is used for funding and interim reimbursement pending the establishment of a final rate for the period. The final rate is an indirect rate based on the actual costs of the period. A provisional rate may be adjusted upward or downward during the fiscal year in order to avoid overpayment or underpayment to the nonprofit. Provisional and final rates shall be negotiated where neither predetermined or fixed rates are appropriate.

13-805.2 Facilities and Administration (F&A) Cost Categories

a. Effective with the June 1998 revision to Circular A-122 (Circular A-122, Attachment A, subparagraph C.3), the Circular requires major nonprofit organizations (i.e., those nonprofit organizations with over \$10 million in direct federal funding) to breakout "indirect costs" into one of two components: "facilities" and "administration." The identification of indirect costs as F&A is required regardless of the allocation method selected to distribute the costs (see 13-805.3). Attachment A, subparagraph C.3 of the Circular, defines "facilities" to include the following cost categories: depreciation and use allowances on buildings; equipment and capital improvements; and operations and maintenance expenses. The "administration" cost groupings include general administration and general expenses such as the director's office, accounting, personnel, and library expenses.

b. An adequate indirect cost proposal will include supporting documentation for both the development of the two broad categories "facilities" and "administration" (as described in Circular A-122 Attachment A, subparagraph C.3) and the overall overhead and/or G&A rate(s). Although major nonprofit organizations' accounting records and indirect cost rate proposals are to make distinctions between F&A costs, the allocations of the nonprofit organizations' indirect costs are to continue to be accomplished through application of an overall overhead and/or G&A rates. The

F&A categories are simply components of the nonprofits' overhead and/or G&A rate(s).

13-805.3 Indirect Cost Allocation Methods

a. Allocation Methods. Nonprofits have the flexibility to select one of the following three methods for allocating indirect cost rates:

(1) Simplified allocation method (Circular A-122, Attachment A, subparagraph D.2);

(2) Multiple allocation base (MAB) method (Circular A-122, Attachment A, subparagraph D.3); or

(3) Direct allocation method (Circular A-122, Attachment A, subparagraph D.4).

b. Simple Allocation Method. Where an organization's major functions benefit from its indirect costs to approximately the same degree, the allocation of indirect costs may be accomplished through an indirect cost rate. If an organization receives more than \$10 million in Federal direct costs, a breakout of the indirect cost component into "Facilities" and "Administration" as discussed at 13-805.2, is required as part of the process in arriving at an overall indirect cost rate.

c. Multiple Allocation Base (MAB) Method. OMB has modified the MAB method effective June 1998 to be more consistent with OMB Circular A-21 (see 13-203). The MAB is now a much more detailed method than in the prior Circular A-122. When a nonprofit organization has several major functions (see Circular A-122, Attachment A, subparagraph D.1.c), which benefit from its indirect costs in varying degrees, the indirect costs are to be accumulated into one of the four separate cost groupings listed below (Circular A-122, Attachment A, subparagraph D.3.b). At major nonprofit organizations the cost groupings are classified within the two broad categories, F&A (13-805.2). Circular A-122, Attachment A, subparagraph D.3.c lists an order of allocation for indirect cost groupings. However, a cross allocation of costs between two or more indirect cost groupings may

be used if such allocation will result in a more equitable allocation of costs. Each cost group is then allocated individually to benefiting functions. The four cost groupings are as follows:

(1) Depreciation and use allowances (Circular A-122, Attachment A, subparagraph D.3.b(1));

(2) Interest (Circular A-122, Attachment A, subparagraph D.3.b(2));

(3) Operation and maintenance expenses (Circular A-122, Attachment A, subparagraph D.3.b(3)); and

(4) General administration and general expenses (Circular A-122, Attachment A, subparagraph D.3.b(4)).

d. Direct Allocation Method. Some nonprofit organizations treat all costs as direct costs except for general administration and general expenses. This method is acceptable provided joint costs are distributed using a base which accurately measures the benefits provided to each award or other activity.

e. The nonprofit organization's selection of bases for allocation of indirect costs may have a substantial effect on federal award costs. Therefore, the auditor should determine that the allocation bases used by the nonprofit organization for allocation of indirect costs are equitable and consistent with Circular A-122. It is likely that when a nonprofit converts to MAB it will require substantial changes to the nonprofit organization's accounting system.

f. A change in allocation base is a change in accounting practice under CFR 9903.302-2, Change to a cost accounting practice, for nonprofit organizations with contracts subject to CAS. Accordingly, the nonprofit organization is required to revise its Disclosure Statement. In addition, nonprofit organizations are required to comply with the requirements of FAR 52.230-6, Administration of Cost Accounting Standards (see 8-500). Consequently, it is the responsibility of the nonprofit organization to determine the materiality of the change in accounting practice. Where applicable, the auditor should ensure the nonprofit organization has made the appropriate revisions to the Disclosure Statement and that it complies with FAR 52.320-6.

13-806 Selected Areas of Cost

13-806.1 Capitalization of Equipment

The capitalization threshold for equipment is the lesser of the amount used for financial statement purposes or \$5,000. Circular A-122, Attachment B, paragraph 15 of the Circular includes guidance on accounting for the undepreciated portion of equipment cost as a result of the nonprofit's change in capitalization levels. The undepreciated portion of equipment costs resulting from an nonprofit organization's change in capitalization levels may be recovered by continuing to claim the otherwise allowable use allowance or depreciation on the equipment, or amortizing the undepreciated amount over a period of years as negotiated between the nonprofit organi-

zation and their cognizant agency for cost negotiations.

13-806.2 Interest – Selected Areas of Cost

Circular A-122, Attachment B, Paragraph 23.a. is intended to encourage nonprofit organizations to acquire, whether by lease or purchase, assets in the manner that would be least expensive. Paragraph 23.a.(1) provides that interest on debt incurred to acquire or replace capital assets (including renovations, alterations, equipment, land, and capital assets acquired through capital leases) is allowable under certain circumstances. The allowability of interest is not retroactive, and only applies to debt to acquire or replace capital assets after September 29, 1995.

13-900 Section 9 --- Audits of Federally Funded Research and Development Centers (FFRDCs)

13-901 Introduction

This section provides auditors with a basic understanding of FFRDCs, applicable regulations, and guidance as to the auditor's responsibilities related to the audit of management fees.

13-902 FFRDC Organizations

a. FFRDCs are organizations established to meet a special long-term research or development need for the federal government which cannot be met effectively by existing federal or contractor resources. The federal agencies sponsoring FFRDCs include: DoD, Department of Energy, the National Science Foundation, the Federal Aviation Administration, the Internal Revenue Service, the National Institutes of Health, and the National Aeronautics and Space Administration. The National Science Foundation maintains a master list of FFRDCs and their government agency sponsors.

b. Each FFRDC is operated by either a commercial organization, nonprofit organization, or educational institution. FFRDCs are generally a separate operational unit within the parent organization. With respect to DoD-sponsored FFRDCs, each is managed by either an educational institution or nonprofit organization under a long term contract, generally for 5 years.

13-903 Federal and DoD Regulations

a. FAR 6.302-3 implements 10 U.S.C. 2304(c)(3) which permits FFRDCs exemption from the Competition in Contracting Act, allowing FFRDCs to receive sole-source contracts.

b. FAR 35.017 prescribes government-wide policies for the establishment, use, periodic audit, and termination of an FFRDC. The policies require agencies to rely on existing government research activities and private industry when practicable to satisfy research and development requirements. DoD sponsors are required to conduct a comprehensive audit of the

use and need for an FFRDC before renewing a contract or agreement for the FFRDC. The detailed examination includes an assessment of the FFRDC's management controls (FAR 35.017-4(c)(4)).

c. The DoD FFRDC Management Plan issued by the Director, Defense Research and Engineering, sets forth the Department's policies and procedures for the management and use of DoD-sponsored FFRDCs. It also provides guidelines and procedures for awarding management fees and ensuring compliance with federal regulations. The publication is available from DCAA Headquarters, Incurred Cost Division.

d. DFARS 215.404-75, provides guidance to the contracting officer to determine whether payment of management fees to FFRDCs is appropriate.

e. Costs incurred by the FFRDC are generally subject to the cost principles applicable to the type of entity operating the FFRDC. An FFRDC operated by a nonprofit organization is subject to FAR 31.7, except as noted in Paragraph 5 and Attachment C of OMB Circular A-122 (see 13-803); an FFRDC operated by an educational institution is subject to FAR 31.3 (see OMB Circular A-21 and 13-203); and an FFRDC operated by a commercial organization is subject to the FAR 31.2 cost principles (see Appendix A-300).

f. All FFRDCs, including those operated by a nonprofit organization or educational institution, are subject to the CASB rules, regulations, and standards for commercial companies.

g. OMB Circular A-133, "Audits of States, Local Governments, and Nonprofit Organizations," is applicable to an FFRDC operated by an educational institution or nonprofit organization (see 13-205).

13-904 Management Fees

a. Management fees are funds that can be provided to FFRDCs in addition to reimbursement of incurred costs. They are

somewhat similar to profit earned by commercial contractors.

b. Although FAR 35.017 sets forth federal policy for establishing, using, reviewing, and terminating an FFRDC, there are no government-wide regulations regarding the development of management fees at FFRDCs. Within DoD, the guidelines for the development of management fees at nonprofit organizations that are DoD sponsored FFRDCs are addressed in: (1) DFARS 215.404-75, Fee requirements for FFRDCs and (2) the DoD FFRDC Management Plan, section D.3, FFRDC Fee. The weighted guidelines method or an alternate approach shall not be used at DoD sponsored FFRDCs.

c. To arrive at a management fee amount in accordance with the preceding guidelines, the contracting officer may seek DCAA's assistance. Although DCAA is not responsible for fee determination, the auditor may be requested to comment on whether the FFRDC's financial and cost data supporting the fee proposal are fairly stated. Since the FFRDC will be recovering the proposed elements as fee and not elements of cost charged to the contract, the auditor's comments regarding fee will not include an audit opinion. Auditors should not offer opinions on the proposed fees as if cost or pricing data had been audited. Rather, the auditor discloses the results of the analysis for consideration by the contracting officer. In any case, the auditor's effort will be limited to furnishing factual information.

d. To assist the contracting officer in determining whether any amount of fee is warranted, Section D.3. of the DoD FFRDC Management Plan (see b. above) calls for the FFRDC to submit an Application of Funds and Sources of Funds Statement to the contracting officer. If determined to be warranted, the FFRDC will then submit a fee proposal to the contracting officer to determine the fee amount. When auditing the FFRDC's Application of Funds and Sources of Funds Statement the auditor should:

(1) identify the types and amounts of proposed fee elements that are not consistent with the criteria contained in the DoD FFRDC Management Plan, and

(2) prepare comments to the contracting officer on this identification. Section D.3.a of the FFRDC Management Plan provides examples of what can be used by the FFRDC to justify and support its proposed fee. These examples include the proportion of the FFRDC's retained earnings that relates to the DoD contracted effort, working capital funding needs, facilities capital acquisition plans, and reimbursement of unreimbursable costs deemed "ordinary and necessary" to the FFRDC's continued successful operation. Examples of areas of concern to the auditor include:

(a) a fee proposal prepared inconsistently with the FFRDC's accounting practices,

(b) a fee proposal including items that are statutorily prohibited from being reimbursed, for example charitable contributions or contract overruns (see 13-906);

(c) a fee proposal including items that should be charged as a cost to the contract, for example sponsored research, IR&D or marketing expenses;

(d) a fee proposal including as elements of fee items that are also recovered as costs charged to the federal award resulting in a duplicate recovery, for example depreciation (see 13-906);

(e) the reliability of the FFRDC's estimates when compared to last year's proposed estimates; and

(f) a fee proposal including items not reimbursable under the contract but considered "ordinary and necessary" to the successful operation of the FFRDC.

13-905 Ordinary and Necessary Costs

One of the criteria used by the contracting officer in determining a fee objective is reimbursement through fee of unreimbursable costs deemed "ordinary and necessary" to the successful operation of the FFRDC. Ordinary and necessary costs used to justify a fee should not include statutorily prohibited costs, allowable (direct or indirect) costs that can be charged to the contract, or costs that are not reimbursable under the appropriate cost principles. If any of these costs are included in the fee proposal as "ordinary and necessary," the auditor shall advise the contracting officer. At the request of the contracting

officer, the FFRDC must demonstrate to the contracting officer's satisfaction that these costs are essential to the FFRDC's successful operation.

13-906 Prohibition Against the Use of DoD Funds for Construction of New Buildings

a. Since FY 1995, every DoD Appropriations Act has included language prohibiting a DoD-sponsored FFRDC from constructing a new building with its reserve funds or management fees (13-904), as long as those funds originate from DoD appropriated funds received during those years while the restrictive language is in effect.

b. Section 8032(c) of the DoD Appropriation Act (PL 106-259) for FY 2001 provides: "Notwithstanding any other provision of law, none of the funds available to the DoD from any source during fiscal year 2001 may be used by a defense FFRDC, through a fee or other payment mechanism for construction of new buildings, for payment of cost sharing for projects funded by government grants for absorption of contract overruns, or for certain charitable contributions, not to include employee participation in community service and/or development." ("Other payment mechanism" refers to profit or award fee, and not to costs that are generally allowable under the cost principles such as depreciation or cost of money.)